SDRs, Currencies, and Gold
Seventh Survey of New Legal Developments

Joseph Gold

INTERNATIONAL MONETARY FUND
Washington, D.C.
IMF PAMPHLET SERIES

INTERNAL MONETARY FUND PAMPHLET SERIES

(All pamphlets have been published in English, French, and Spanish, unless otherwise stated)


*2. The International Monetary Fund: Its Form and Functions, by J. Marcus Fleming. 1964. In English only.


22. Floating Currencies, SDRs, and Gold: Further Legal Developments, by Joseph Gold. 1977. Concluding section also in German.


(Continued on inside back cover)

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1987
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PREFATORY NOTE

This pamphlet is the seventh survey of developments in international and national monetary law and practice involving SDRs, currencies, and gold. These developments have occurred as the result of the Second Amendment of the Articles of Agreement of the International Monetary Fund, which became effective on April 1, 1978, or of the circumstances that led to that event. The developments are related mainly to three principles that are recognized by the present Articles: the SDR is to become the principal reserve asset in the international monetary system; members are free, now that the par value system has been abrogated, to choose their exchange arrangements and to determine the external value of their currencies; and the role of gold in the international monetary system is to be gradually reduced.

Earlier surveys of legal developments that have been influenced by these three principles have appeared in the Fund’s Pamphlet Series as Nos. 19, 22, 26, 33, 36, and 40, and are referred to in this pamphlet by the appropriate number in the series. A consolidated list of cases and a consolidated index of topics for the seven pamphlets are included in this pamphlet (pages 147–62).

References to the Articles are to the Articles of Agreement of the International Monetary Fund. References to the Second Amendment are to that amendment of the Articles.

The opinions expressed in this pamphlet are those of the author, now Senior Consultant and formerly the General Counsel and Director of the Legal Department of the International Monetary Fund, and they do not necessarily represent the opinions of the Fund.

June 1986
SDRs, Currencies, and Gold

Seventh Survey of New Legal Developments

SDRs

Valuation

The Fund's decision of September 17, 1980 on the second revision of the basket of currencies that determines the value of the special drawing right (SDR) and the principles and procedures for subsequent revisions were discussed in Pamphlet No. 36. The decision listed the currencies and their weights that were to compose the basket; this method of valuation took effect on January 1, 1981. The decision provides that the list of currencies that determines the value of the SDR, and the amounts of these currencies, shall be revised with effect on January 1, 1986, which is to say five years after the effective date of the second revision, and on the first day of each subsequent quinquennial period. The revision is to be made in accordance with the principles set forth in the decision unless the Fund decides otherwise in connection with a revision. For convenience, these principles are repeated here:

a. The currencies determining the value of the special drawing right shall be the currencies of the five members whose exports of goods and services during the five-year period ending 12 months before the effective date of the revision had the largest value, provided that a currency shall not replace another currency included in the list at the time of the determination unless the value of the exports of goods and services of the issuer of the former currency during the relevant period exceeds that of the issuer of the latter currency by at least one per cent.

b. The amounts of the five currencies referred to in a. above shall be determined on the last working day preceding the effective date of the relevant revision in a manner that will ensure that, at the average exchange rates for the three-month period ending on that date, the shares of these currencies in the value of the special drawing right correspond to percentage weights for these currencies, which shall be established for each currency in accordance with c below.

c. The percentage weights shall reflect the value of the balances of that currency held at the end of each year by the monetary authorities of other members and the value of the exports of goods and services of the issuer of the currency over the relevant five-year period referred to in a. above, in a manner that would maintain broadly the relative significance of the factors that underlie the percentage weights in paragraph 2 above. The percentage weights shall be rounded to the nearest 1 per cent or as may be convenient.
SORs, CURRENCIES, AND GOLD

4. The determination of the amounts of the currencies in accordance with 1 and 3 above shall be made in a manner that will ensure that the value of the special drawing right in terms of currencies on the last working day preceding the five-year period for which the determination is made will be the same under the valuation in effect before and after revision.\(^2\)

The valuation basket that became effective on January 1, 1981 was composed as follows:

<table>
<thead>
<tr>
<th>Currency</th>
<th>Weight (in percent)</th>
<th>Amount (in units of currency)</th>
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</thead>
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<tr>
<td>U.S. dollar</td>
<td>42</td>
<td>0.54</td>
</tr>
<tr>
<td>Deutsche mark</td>
<td>19</td>
<td>0.46</td>
</tr>
<tr>
<td>French franc</td>
<td>13</td>
<td>34.00</td>
</tr>
<tr>
<td>Japanese yen</td>
<td>13</td>
<td>0.74</td>
</tr>
<tr>
<td>Pound sterling</td>
<td>13</td>
<td>0.071</td>
</tr>
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</table>

The basket has been revised, with effect on January 1, 1986, in accordance with the principles set forth in the decision of September 17, 1980, and is composed as follows:

<table>
<thead>
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<th>Currency</th>
<th>Weight (in percent)</th>
<th>Amount (in units of currency)</th>
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<tbody>
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<td>U.S. dollar</td>
<td>42</td>
<td>0.452</td>
</tr>
<tr>
<td>Deutsche mark</td>
<td>19</td>
<td>0.527</td>
</tr>
<tr>
<td>Japanese yen</td>
<td>15</td>
<td>33.4</td>
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<td>French franc</td>
<td>12</td>
<td>1.02</td>
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<tr>
<td>Pound sterling</td>
<td>12</td>
<td>0.0893</td>
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Rule O-1 of the Fund’s Rules and Regulations has been amended to state that the value of the SDR shall be the sum of the amounts of the currencies shown above.\(^3\)

The list of currencies remained unchanged because the share of the sixth largest exporter of goods and services in the world total (Italy) was below the share of the member with the fifth largest share (United Kingdom). According to the decision of September 17, 1980, a currency in the basket is not replaced by another currency unless the value of the exports of goods and services of the issuer of the latter currency during the relevant period exceeds that of the former currency by at least 1 percent.

The Fund announced the new weights for currencies in the basket that would take effect on January 1, 1986 in a press release of September 23,
SORs

1985. The new weights were made public in accordance with the practice of completing and announcing revisions by the end of the September before they become effective, so that official and private parties have three months in which to familiarize themselves with the revised composition and any associated developments in procedures. This interval enables other entities that are using the SDR as a denominator or unit of account for some purpose, and that have sufficiently flexible powers, to decide whether to follow the revision or to abide by the composition of the SDR that preceded the revision.

The amounts of units of the currencies in the basket, rather than the percentage weights of currencies, are used in daily calculations involving the SDR. Paragraphs 3(b) and 4 of the decision of September 17, 1980 require (i) that the amounts of currency correspond to the given agreed weights for a revised basket when applied to the average exchange rates over the reference period of three months before the revision takes effect, and (ii) that the revised basket will have the same value for the SDR in transactions on the first working day on which the revision is in effect as the value of the SDR on the last working day before the revision took effect. The currency amounts are rounded, without prejudice to the requirements of preserving the given percentage shares of currencies and the equality of exchange rates for the SDR on the two working days. The guidelines for rounding the units of currency in the basket endorsed for calculating the currency amounts on December 31, 1980 were as follows:

(1) Under all circumstances, the currency units will be determined in a manner which would ensure that the value of the SDR calculated on December 31, 1980 on the basis of the new basket will be the same as that actually prevailing on that day.

(2) The currency amounts calculated for the new basket will be expressed in two significant digits provided that the percentage deviation over the agreed weight for each currency in the value of the SDR resulting from the application of the average exchange rate for October–December 1980 is the minimum on average and will not exceed one-half percentage point for any currency.

(3) If a solution cannot be obtained by the application of the principle set forth in (2) above, the significant digits to which currency amounts will be expressed may exceed two for one or more currencies but not exceed four for any currency provided that the shares of component currencies over the averaging period (October–December 1980), when appropriately rounded, are the same as the percentage weights set forth in paragraph 2 of the Executive Board’s Decision No. 6631–(80/145) G/S, adopted on September 17, 1980.
(4) If more than one solution is found, the solution that has the smallest average deviation will be employed.

The guidelines were revised by a decision of the Executive Board that took effect on December 26, 1985 to read as follows:

(1) Under all circumstances, the currency units will be determined in a manner which would ensure that the value of the SDR calculated on December 31 on the basis of the new basket will be the same as that actually prevailing on that day.

(2) The currency amounts calculated for the new basket will be expressed in two significant digits provided that the deviation of the percentage share of each currency in the value of the SDR, resulting from the application of the average exchange rates for October-December, from the percentage weight as determined under paragraph 3(c) of Executive Board Decision No. 6631-(80/145) G/S adopted September 17, 1980 is the minimum on average and will not exceed one-half percentage point for any currency.

(3) If a solution cannot be obtained by the application of the principles set forth in (2) above, the calculation shall be made applying the same principles but expressing the amount of each currency in three significant digits, and if no solution is found with three significant digits then the calculation shall be made applying the same principles but expressing the amount of each currency in four significant digits.

(4) If more than one solution is found in the calculation at the level of two, three, or four significant digits, the solution that has the smallest average deviation will be employed.

The third revised basket for valuation of the SDR applies for the purpose of the interest rate basket also. The baskets had been separate but were unified with effect on January 1, 1980. One of the changes that took effect on that date was that the weights in the interest basket were changed from a fixed-weight system to a system of fixed amounts of currency. As a result, the weights "float," because of the involvement of exchange rates. The weights "float" because the interest rate on an instrument in the basket is multiplied by the number of units of the currency in which the instrument is denominated and the value of a unit of that currency in the market in terms of the SDR as determined by the Fund under Rule 2(a) and (b) of the Rules and Regulations. The five products are added together to determine the interest rate on the SDR.

The criteria that have guided the choice of the instruments in the SDR basket are the same as those discussed in Pamphlet No. 36. The criteria are based on the broad proposition that as there is no market for the SDR in which the interest rate is determined, the interest rate should be closely

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related to interest rates in the domestic markets for the five currencies on widely available instruments that are comparable in risk characteristics to the SDR as an official asset.

**Interest**

The Fund pays interest to participants in the Special Drawing Rights Department on holdings of SDRs in excess of allocations and on all holdings of SDRs by other holders. The Fund levies charges on participants on the excess of allocations over holdings at the same rate as the rate of interest. Both the frequency with which the interest rate on holdings of SDRs is established and the frequency with which interest is paid are among the important elements that determine the attractiveness of the SDR as a reserve asset. Since 1974, the interest rate has been set by reference to the rates on specified instruments available in the capital markets of the five countries whose currencies enter into the composition of the SDR valuation basket. From July 1, 1974 to June 30, 1976, the interest rate was established at intervals of six months according to the weighted average of market rates on the component instruments (the "combined market rate"). The rate was established for a "reference period" of three months ending on the fifteenth day of the last month before the six-month period to which the rate applied. The combined market rate for the two years was determined by a complex formula that resulted in an average rate of 56 percent of the combined market rate over the two years.

Beginning on July 1, 1976, the interest rate was adjusted quarterly instead of half-yearly, and the reference period was reduced from three months to six weeks. The objective of a reference period, and averaging over the course of it, is to moderate the effect of temporary influences on the rate and to take account of trends. The interest rate was increased from 60 percent of the combined market rate (July 1, 1976 to December 31, 1978) to 80 percent (January 1, 1979 to April 30, 1981) and then to 100 percent (since May 1, 1981). With effect from January 1, 1981, both the reference period and the lag between the reference period and the quarterly period to which the rate applied were shortened, so that the rate would be closer to rates in the markets. Since January 1, 1981, the combined market rate has been calculated according to the weighted average rates of the 15 business days preceding the last 2 business days of the last month before the calendar quarter to which the rate applied.
SDRs, CURRENCIES, AND GOLD

Rule T-1 of the Rules and Regulations was amended on July 26, 1983, with effect on August 1, 1983, to enhance the role of the SDR as an international reserve asset by bringing its yield closer in line with the yields on other reserve assets. The texts of Rule T-1 before and after amendment of it are reproduced in Appendix A.9

In order to enhance the attractiveness of the SDR in comparison with other reserve assets, the amendment relates the effective yield on holdings of SDRs to the effective yield on the currencies of members in the form in which they are likely to be held in the reserves of other members. The amendment is based on the approach of setting the interest rate on holdings of SDRs by reference to the interest rates that could be earned on specified three-month investments in the currencies that compose the unified valuation and interest rate baskets. As noted above, the former interest rate on holdings of SDRs was set at intervals of calendar quarters, for which reason it often diverged substantially, both relatively and in absolute amounts, from prevailing rates of interest in the market on other investments, including investments according to the SDR interest rate basket. As most of the interest rates on investments in which members hold reserves are repriced daily in the money markets of the world, a daily adjustment of the interest rate on holdings of SDRs was considered. This course was not followed, although it was the standard against which the revised practice has been evaluated. It was found that a weekly adjustment would be fairly close to a daily adjustment. Furthermore, a weekly adjustment would be a lesser change from earlier practice, as well as simpler to administer. The amended Rule T-1 uses the daily combined market rate of the Friday before a weekly adjustment. The use of this rate for a single day is close to practice in the market and reduces the lag between the reference period and the period to which the rate applies.

The rate of interest on holdings of SDRs by all holders and the rate of charges on allocations of SDRs by the Fund to participants in the Special Drawing Rights Department must be the same.10 Furthermore, the rate of interest is the same for all holders,11 and the rate of charges is the same for all participants.12 Before the amendment of Rule T-1, charges on allocations of SDRs and interest on holdings of SDRs were settled annually as of the end of each financial year of the Fund.13 Interest and charges accrued daily, and they continue to accrue in this way under the amended Rule T-1. The accounts of participants were either credited with the excess of interest due over charges payable or debited with the excess
of charges payable over interest due. Holders other than participants do not receive allocations and therefore do not pay charges. The accounts of holders that were not participants were credited with interest due. These practices on settlements, other than the date of settlements, are unchanged under the amended Rule T-1.

Interest on the instruments in the interest rate basket is usually received more frequently than annually, and most often at intervals of three months. As a result of compounding, the interest on holdings of SDRs was lower, in effect, than the return of consecutive investments in the instruments that compose the interest rate basket. The amended Rule T-1 adopts the practice of quarterly settlements, so as to narrow the gap to a considerable extent between the interest paid on holdings of SDRs and the interest earned by investing in the instruments composing the SDR interest rate basket.

As quarterly payments of charges on allocations of SDRs are smaller than annual payments, it may be easier for participants with modest or no holdings of SDRs to acquire them in sufficient amounts to discharge the obligation to pay charges. A participant is required and entitled to obtain the necessary SDRs, in exchange for a currency acceptable to the Fund, in a transaction with the Fund conducted through the General Resources Account. If sufficient SDRs cannot be obtained in this way, the participant is required and entitled to obtain them, in exchange for a freely usable currency, from a participant specified by the Fund. This compulsory surrender of SDRs is the only case under the Articles in which one participant is required to transfer SDRs to another participant in the course of the ordinary operation of the SDR system. The policy of assuring participants that the SDR is a trustworthy asset because interest on it will be paid is paramount over the assurance participants receive that they cannot be deprived of their holdings by compulsory surrender to another participant.

The policy of assuring holders that they will receive interest even if a participant delays the payment of charges on the allocations of SDRs it has received dictated the provision of the Articles that the Fund must create sufficient SDRs to complete the payment of interest to all holders of SDRs. The delayed payment means that the Fund has received insufficient charges to pay all interest from charges, because the SDR system is constructed in such a way that total interest is equal to total charges.
The participant that delays the payment of charges pays charges on the total of allocations of SDRs to it and the amount of its unpaid charges. This provision is again designed to ensure a balance between total charges and total interest, because the SDRs created by the Fund to complete the payment of interest will be held by participants as part of their total holdings of SDRs on which they will receive interest. If a delinquent participant receives SDRs after the date for payment, the SDRs will be applied against its unpaid charges and cancelled. In this way, the disparity between total allocations of SDRs and total holdings of SDRs is reduced and eventually eliminated.

Quarterly payments of charges may be a smaller burden for participants and, therefore, may reduce the need for the Fund to create SDRs to pay interest on holdings. Although quarterly payments might be advantageous for participants by requiring them to make smaller periodic payments of charges, quarterly payments might also mean higher effective charges because of the compounding of reductions in holdings of SDRs. Quarterly payments of interest cannot be reconciled legally with payments of charges at longer intervals. The consequence of such a difference in practice could be the need for the Fund to create large amounts of SDRs on repeated occasions in order to pay the full amount of interest due. The connotation of “unpaid charges” is that they are undesirable. It would be difficult to regard charges not yet due for payment as “unpaid charges,” and yet if this step were not taken provisions of the Articles in which the expression occurs would become unworkable.

Under Rule T-1 before amendment, interest and charges had to be paid promptly as of the end of each financial year of the Fund. In order to make these payments, the Fund’s accounts had to be reopened on that day after being closed to enable transfers of interest and charges to be effected after the balance in each account resulting from other transfers was established and accrued interest or charges on the balance were calculated. Under the revised Rule T-1, interest and charges do not begin to accrue on newly credited and debited amounts until the first day of the following period. Rule T-1(a) has been revised to provide that interest and charges will be paid promptly as of the first day of the new accounting period. The change is in accounting only, without any effect on the amounts of interest and charges that are calculated.
“Other Holders” of SDRs

Under Article XVII, Section 3(i) the Fund may prescribe the following entities as holders of SDRs: (1) nonmembers of the Fund, (2) members that are nonparticipants in the SDR Department, (3) institutions that perform functions of a central bank for more than one member, and (4) other official (but not private) entities. The Eastern Caribbean Central Bank has been prescribed. It has succeeded the East Caribbean Currency Authority, which went out of existence on October 1, 1983 and was itself a prescribed holder of SDRs. The members of the Authority were Antigua and Barbuda, Dominica, Montserrat, Grenada, St. Christopher and Nevis, St. Lucia, and St. Vincent and the Grenadines. The seven governments of these countries decided to replace the Authority with a new institution that would have the full powers of a central bank, and therefore broader powers than those of the Authority.

The Agreement Establishing the Eastern Caribbean Central Bank provides that, as from the effective date of the Agreement (October 1, 1983), the East Caribbean Agreement, under which the Authority was created, shall cease and terminate, and the Authority be deemed to cease to exist. The new Agreement, made on July 5, 1983, provides in addition that, on the date of the establishment of the Bank,

all the assets and liabilities of the Authority, together with all its rights and obligations that are not inconsistent with the provisions of this Agreement, shall be deemed to have been transferred to and to vest in the Bank.20

The Authority held SDR 700,000. The Bank, though a successor, was a new organization, so that it would not have been entitled automatically under the Articles to be a prescribed holder of SDRs or to take title to the SDRs formerly held by the Authority.

The Bank applied for prescription as a holder in succession to the Authority. The Fund decided on May 17, 1984 that, with effect from October 1, 1983, the Bank is prescribed in place of the Authority, and that

the records of the SDR Department shall indicate that as of October 1, 1983, the Bank acquired title to all SDRs held by the Authority.21

The Bank is entitled to accept, hold, and use SDRs in transactions and operations in accordance with the standard terms for “other holders” of SDRs as amended from time to time. The prescription required a majority of 85 percent of the total voting power of all participants in the SDR
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Department, which in fact means all members, but for the rest of the decision a majority of the votes cast was sufficient.

A notable feature of this case is that between October 1, 1983, when the Authority went out of existence, and May 17, 1984, when the Fund prescribed the Bank, the SDRs of the Authority were credited to a nonexistent holder. When the Fund prescribed the Bank, the prescription was made retroactive to October 1, 1983.

The African Development Bank and the African Development Fund, which is affiliated with that Bank, were prescribed as other holders on June 25, 1986, with effect on that date. (The use of the SDR as a unit of account by these organizations is discussed on pages 22–23 of Pamphlet No. 33.)

There are now 16 prescribed “other holders,” as follows:

(1) four central banks:
   Bank for Central African States, Yaoundé
   Central Bank for West African States, Dakar
   Eastern Caribbean Central Bank, Basseterre, St. Kitts
   Swiss National Bank, Zürich

(2) three intergovernmental monetary institutions:
   Andean Reserve Fund, Bogotá
   Arab Monetary Fund, Abu Dhabi
   Bank for International Settlements, Basle

(3) nine intergovernmental development institutions:
   African Development Bank, Abidjan
   African Development Fund, Abidjan
   Asian Development Bank, Manila
   East African Development Bank, Kampala
   International Bank for Reconstruction and Development, Washington, D.C.
   International Development Association, Washington, D.C.
   International Fund for Agricultural Development, Rome
   Islamic Development Bank, Jeddah
   Nordic Investment Bank, Helsinki

“SDR” as Common Usage

Even before the date of the First Amendment of the Articles, it was recognized that the expression “special drawing right” was unsatisfactory. The objections were more than aesthetic. The expression was not
compatible with jurisprudential concepts. A political compromise prevailed, the purpose of which was to obscure somewhat the character of the special drawing right as a reserve asset by implying a relationship to the use of the Fund’s resources by means of so-called “drawings.” There is irony in making a further use of that word because it too is not a happy reflection of the legal character of the transaction by which a member uses the Fund’s resources. The drafters of the original Articles carefully used the language of a member’s purchase of another currency in return for the sale of its own currency. This usage has remained in the Articles, which at no time have referred to the member’s transactions with the Fund as “drawings.” Meanwhile, the acronym “SDR” has become a common coinage within the Fund and outside it. The Fund has decided to give some form of official recognition to the acronym in the hope that it will cease to be regarded as an abbreviation and will have a legitimacy of its own. This further exercise in semantics has taken the form of Rule B-6 of the Fund’s Rules and Regulations, which was adopted by the Executive Board on July 26, 1983:

SDR refers to the special drawing right of the Fund. The term “SDR” (or “SDRs,” as appropriate) shall be adopted as standard usage in Fund documents, correspondence and publications where a reference to special drawing rights is intended, provided that if the text is in a language in which a different usage has become established, that usage may be retained.

The rule is binding only within the Fund. The proviso also refers to documents, correspondence, and publications of the Fund. The rule does not amend the Articles, so that, to take one example, quotations of provisions must be in the authentic text. The hope implicit in the rule is that members for whom English is not the native language will use the expression SDR rather than an acronym derived from a translation of “special drawing rights.” Japan and the Netherlands refer to the “SDR,” and perhaps other members have adopted this usage.

Rule B-6 declares that “SDR” refers to the special drawing right. By the same technique, the rule might declare that any name deemed more appropriate refers to the special drawing right within the same limited area covered by the rule. But, of course, any such proposal would become mired in a welter of names proposed and counterproposed.

International Conventions

A checklist of the international conventions or proposed conventions in which the SDR performs a function, usually as unit of account, was
published in Volume 22 of International Legal Materials. The functions of the SDR in most of these conventions have been discussed in the earlier pamphlets on new legal developments published by the Fund. Some further conventions are discussed in this pamphlet.

Commonwealth countries are eligible for membership in the Commonwealth Telecommunications Organization (CTO), which has been established for such purposes as the efficient exploitation and development of the Commonwealth external telecommunications system, consultation and the dissemination of information and advice in this field, and machinery for the administration of collaborative financial arrangements. The governing body of the CTO, the Council, agreed that a hypothetical unit of account should be adopted as a means of minimizing the impact of changes in exchange rates. "and that the SDR appeared to be the unit best able to meet the criteria of stability, convertibility, and neutrality." In 1976, the Council of the CTO decided to adopt the SDR as defined by the Fund as the unit of account for the purpose of the Commonwealth Telecommunications Financial Arrangements, with effect from April 1, 1975. The SDR remains the unit of account under the revised Arrangements that took effect on April 1, 1983. The U.S. dollar is the currency of settlement. The SDR is the unit of account under the new Commonwealth Telecommunications Programme of Development and Training (PDT), which took effect on the same date.

The International Conference on Liability and Compensation for Damage in connection with the Carriage of Certain Substances by Sea, which was held under the auspices of the International Maritime Organization in London from April 30 to May 25, 1984, reached agreement on the Oil Pollution Liability Convention 1984 and the Oil Pollution Fund Convention 1984, both of which were adopted on May 25, 1984. These two conventions, on entry into force, will amend earlier conventions and protocols, beginning with the International Convention on Civil Liability for Oil Pollution Damage, which was done at Brussels on November 29, 1969 and entered into force on June 19, 1975.

Under the 1984 Oil Pollution Liability Convention, the owners of a ship at the time of an incident causing oil pollution damage or creating a grave and imminent threat of damage resulting from the escape or discharge of oil from the ship shall be liable for the damage. Under Article V, paragraph 1, the owner is entitled to limit his liability in respect of any one
incident to specified amounts of “units of account” determined according to the tonnage of the ship, but in no event exceeding a specified maximum. To avail himself of the benefit of limitation, the owner must constitute a fund, for the amount of his limited liability, with the court or other competent authority of a contracting state in which an action is or can be brought. Under Article V, paragraph 9(a):

The “unit of account” referred to in paragraph 1 of this Article is the Special Drawing Right as defined by the International Monetary Fund. The amounts mentioned in paragraph 1 shall be converted into national currency on the basis of the value of that currency by reference to the Special Drawing Right on the date of the constitution of the fund referred to in paragraph 3. The value of the national currency, in terms of the Special Drawing Right, of a Contracting State which is a member of the International Monetary Fund shall be calculated in accordance with the method of valuation applied by the International Monetary Fund in effect on the date in question for its operations and transactions. The value of the national currency, in terms of the Special Drawing Right, of a Contracting State which is not a member of the International Monetary Fund shall be calculated in a manner determined by that State.

Under Article V, paragraph 9(b), a Contracting State that is a nonmember of the Fund and that cannot under its law apply paragraph 9(a) may declare, at the time of ratifying the Convention or at any later date, that the unit of account referred to in paragraph 9(a) shall be equal to 15 “gold francs.” The gold franc is defined by reference to an amount of gold that corresponds to the definition of the Poincaré franc but is not mentioned as such. The translation of the gold franc into the national currency shall be made according to the law of the State concerned.

Under paragraph 9(c), the translation of the gold franc “shall be made in such manner as to express in the national currency of the Contracting State as far as possible the same real value for the amounts in paragraph 1 as would result from the application” of the SDR by members of the Fund. Nonmembers must communicate to the depositary the manner of calculation pursuant to paragraph 9(a) or the result of the conversion under paragraph 9(b).

It follows that the SDR must be the basis for calculation of the limit on liability if the law of a Contracting State that is a nonmember of the Fund does not prohibit this technique, but the method by which the SDR is translated into the Contracting State’s currency is determined by that state. If the Contracting State’s law prohibits calculation on the basis of the
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SDR, the Poincaré franc is the unit of account for that state, but the calculation must be made in such manner as would result, as far as possible, in "the same real value" as calculation on the basis of the SDR by members of the Fund (and not by those nonmembers that make calculations on the basis of the SDR as they determine). What is meant by "the same real value" is not defined, and an attempt at clarification might provoke controversy.

The 1984 Oil Pollution Liability Convention eliminates the expression "monetary unit" that appeared in earlier conventions. The sole expression is "unit of account," and the SDR is the only unit of account. The Poincaré franc is neither a unit of account nor a monetary unit; it is said only that a nonmember of the Fund whose law prevents application of the SDR may declare that for the nonmember 15 gold francs are equal to the unit of account. This equivalence is based on the definition of the Poincaré franc and the former definition of the SDR in terms of gold. In the earlier conventions, the Poincaré franc was referred to as the "monetary unit."

Any claim for compensation for oil pollution damage may be brought directly against the insurer or other person providing financial security for the owner's liability for pollution damage. In such case, the defendant may avail himself of the limits on liability even if the owner is not entitled to limit his liability because of the owner's personal act or omission, committed with either intent to cause the damage or recklessly and with knowledge that such damage would probably result.

Article 15 of the Convention sets forth a procedure for amendment of the limits of liability. The procedure can be invoked by at least one fourth of the Contracting States. The Legal Committee considers the proposal and may adopt (in reality, endorse) amendments by a specified majority, provided the quorum provision is satisfied. The Committee must take certain factors into account, including "changes in the monetary values." No limit may be increased beyond a specified annual amount or beyond a specified multiple of the amount laid down in the Convention. An amendment is deemed to have been accepted at the end of a period of 18 months after notification to the Contracting States of the Committee's favorable action, unless within that period not less than one fourth of the Contracting States inform the International Maritime Organization that they do not accept the amendment. All Contracting States are bound by an amendment, unless they follow the procedure for denunciation of the Protocol that deals with amendment of the limits.
The 1984 Oil Pollution Fund Convention is designed to establish an international fund for compensation for pollution damage to the extent that the protection afforded by the 1984 Oil Pollution Liability Convention is inadequate. Inadequacy is defined as the absence of liability under the Liability Convention, the financial inability of the owner to meet his obligations in full and the absence of complete satisfaction by such financial security as is provided, or damage in excess of the limits on liability. Except as otherwise provided in the Oil Pollution Fund Convention, the aggregate amount of compensation payable by the Pollution Fund shall be limited in respect of any one incident, so that the total sum of that amount and the amount of compensation actually paid under the 1984 Liability Convention do not exceed a stated amount of units of account. All of the provisions on compensation refer to amounts in units of account, and it is then provided that:

The amounts mentioned in this Article shall be converted into national currency on the basis of the value of that currency by reference to the Special Drawing Right on the date of the decision of the Assembly of the [Pollution] Fund as to the first date of payment of compensation.33

This provision appears to freeze the calculation of amounts of currency payable as compensation by reference to the SDR as of a date to be fixed by the Assembly.

The unit of account appears in provisions of the Oil Pollution Fund Convention that instruct the Assembly on the factors it is to take into account in deciding on the total amount of contributions to be levied. For this reason Article 1, paragraph 4, provides that "'Unit of account' has the same meaning as in Article V of the Liability Convention." The Oil Pollution Fund Convention contains provisions on amendment of the limits on liability that parallel the provisions of the Oil Pollution Liability Convention.34

In Pamphlet Nos. 3335 and 36,36 an account will be found of efforts to substitute by formal and final legal action the SDR for the Germinal franc as the monetary unit of the Universal Postal Union (UPU). The Germinal franc is the gold monetary unit established by Article 7 of the UPU's Constitution, the paramount instrument in the complex of UPU's legal instruments. A two-thirds majority of the membership is necessary for amendment of the provision. A proposal to amend Article 7 did not receive the necessary support when the Congress of the UPU met at Rio de Janeiro in September and October 1979. The monetary unit has practical
and technical importance among postal authorities only under the Convention, which is the principal Act of the UPU, and other subordinate legal instruments. Article 8 of the Convention was amended at Rio de Janeiro to provide that “the monetary unit in the Convention and the Agreements as well as in their Detailed Regulations shall be the gold franc laid down in Article 7 of the Constitution convertible into the International Monetary Fund (IMF) accounting unit which is at present the Special Drawing Right (SDR).”

At the 19th Congress of the UPU held at Hamburg in June and July 1984, 26 members proposed to amend Article 7 of the Constitution to read:

The monetary unit used as the monetary standard in the Acts of the Union shall be the accounting unit of the International Monetary Fund (IMF).37

The reasons offered in favor of the proposal included, among others, the “demonetization of gold” and the prohibition of any reference to gold in fixing the value of the currencies of members of the Fund; the use of the SDR by the majority of postal administrations since the Rio de Janeiro Congress; and the effect of the proposal in eliminating any need to amend Article 7 of the Constitution in the future “because of the widespread and frequent fluctuations in currencies.”

Once again, the proposal failed by a few votes to get the support of the necessary two thirds of the membership. The proposal was opposed by nonmembers of the Fund that expressed support for the gold standard and declared that they would be embarrassed by mention of the SDR. The U.S.S.R., however, while supporting the gold standard, thought that the Constitution should reflect reality by recognizing the SDR. Some members of the Fund as well as some nonmembers failed to support the proposed amendment because high inflation in their countries would be disadvantageous to them if the SDR were the monetary unit.

Once again, a less solemn solution, although apparently an adequate one in practice, was found. China submitted a proposed resolution that recited international currency developments, the demonetization of gold, the widespread use of the SDR by the majority of postal administrations, and “the need to envisage standardized provisions concerning the use of this accounting unit of the International Monetary Fund (IMF).”38 In view of these recitals, the UPU Congress was invited to decide that amounts expressed in gold francs and gold centimes in the Acts of the UPU shall henceforth be supplemented by their exchange value in SDR calculated
on the basis of the linking coefficient of 1 SDR = 3.061 g fr. in accordance with the arrangements provided for in International Bureau circular 219 of 1 September 1980.\(^\text{39}\)

The reason advanced for the resolution was that as the SDR was already widely used by the majority of postal administrations, it appeared necessary to have standardized provisions concerning the practice. The resolution was adopted with effect from January 1, 1986, and in accordance with it, amendments were made in many articles of the Convention and other Acts of the UPU. The linking coefficient between the SDR and the Germinal franc is based on the definitions in terms of gold of the SDR before the Second Amendment of the Fund’s Articles and the Germinal franc.

At its Annual Meeting in 1985, the Board of Governors of the International Bank for Reconstruction and Development (World Bank) adopted a resolution approving a proposed Convention Establishing the Multilateral Investment Guarantee Agency (MIGA) and opening the Convention for signature by members of the Bank and Switzerland. The objective of the MIGA is to encourage the flow of resources to its developing members by issuing guarantees, as well as coinsurance and reinsurance, against noncommercial risks and by carrying out complementary activities. The four broad categories of these risks would be: (1) the transfer risk resulting from host government restrictions on conversion and transfer; (2) the risk of loss resulting from legislative action, administrative action, or omission of the host government that has the effect of depriving the investor of his ownership, control, or substantial benefit of his investment; (3) the risk resulting from repudiation of a contract by the host government when the investor has no access to a competent forum, faces unreasonable delays, or is unable to enforce a final judgment; and (4) the risk of war and civil disturbance.

The role of the SDR under the proposed Convention is in the definition of capital:

(a) The authorized capital stock of the Agency shall be one billion Special Drawing Rights (SDR 1,000,000,000). The capital stock shall be divided into 100,000 shares having a par value of SDR 10,000 each, which shall be available for subscription by members. All payment obligations of members with respect to capital stock shall be settled on the basis of the average value of the SDR in terms of United States dollars for the period January 1, 1981 to June 30, 1985, such value being 1.082 United States dollar per SDR.
(b) The capital stock shall increase on the admission of a new member to the extent that the then authorized shares are insufficient to provide the shares to be subscribed by such member pursuant to Article 6.

(c) The Council, by special majority, may at any time increase the capital stock of the Agency.  

The value of the SDR is “fixed.” The value of the unit, expressed as SDR 1 = US$1.082, could have been substituted for the reference to the SDR. It was probably helpful in the negotiations to mention the SDR. January 1, 1981 was chosen because the method of valuing the SDR in force during the negotiations on the MIGA had become effective on that date.

Each original member of the Agency subscribes at par to the number of shares set forth opposite its name in Schedule A to the Convention. Other members of the Agency subscribe “to such number of shares of capital stock on such terms and conditions” as are determined by the Council of the Agency, but in no event at an issue price of less than par. The Council may prescribe “rules by which members may subscribe to additional shares of the authorized capital stock.” The “terms and conditions” and the “rules” referred to in the clauses quoted here do not refer to the fixed SDR as the unit of account for the shares of nonoriginal members and for additional shares, but it is probably implicit in Article 5(a) that the same unit of account would be applied.

The Economic Community of the Countries of the Great Lakes (La Communauté Économique des Pays des Grand Lacs (CEPGL)) was created by Burundi, Rwanda, and Zaire on September 20, 1976. The purposes of the treaty constituting the Community are collective security, development, the promotion of trade and freedom for the movement of persons and goods, and the harmonization and coordination of policies in various fields. The SDR performs several functions in Community arrangements. For example, the value of goods in SDRs is a criterion for determining what goods move freely within the Community. Intergovernmental and Community organs are established, and each category is subdivided into general and specialized organs. The budget of the Executive Secretary, which is the sole general organ of the Community, is expressed in units of account. The SDR has been chosen as the unit of account. One of the specialized Community organs is the Development Bank of the States of the Great Lakes, which was created by an agreement
of September 9, 1977. Its capital is expressed in units of account. For this purpose also the SDR has been selected as the unit of account. 42

**SDR Basket as Analogy**

Under this same heading in Pamphlet No. 33, the practice was discussed of applying the composition of the SDR basket not only as a unit of account or as a denominator but as a model for different purposes. An aspect of what is referred to as the Organization for Economic Cooperation and Development (OECD) Arrangement on Guidelines for Officially Supported Export Credits can be classified under the same heading.

The 22 members of the OECD that belong to the Group on Export Credits and Credit Guarantees of the OECD Trade Committee reached an informal “Consensus” to avoid destructive competition on export credit that was leading to an undesirable race in this field. The Consensus established certain rules, including minimum permissible rates of interest, for most officially supported export credits of two years or more. On April 1, 1978, these rules were incorporated into the Arrangement referred to above. The participants meet at OECD headquarters for an annual review of the functioning of the Arrangement.

What has been described as the most serious weakness of the Arrangement was the rigidity of minimum rates of interest, which could be changed only after long negotiations that produced unanimous agreement on a new set of rates. Another cited weakness was that there were no guidelines on interest rates for official export credits (that is, direct government loans and government subsidized loans as opposed to government guarantees) in currencies for which market rates of interest were below the minimum rates of the Arrangement.

In October 1983, the Arrangement was modified to provide for semiannual adjustments of interest rates. The earlier division of the world into three categories of buyer countries is retained: relatively rich, intermediate, and relatively poor. Minimum interest rates, called the interest rate matrix, apply to all credits for which governments provide official financing support by direct credit, refinancing, or interest rate subsidy. Officially supported export credits denominated in currencies for which the private market provides fixed rates of interest below the relevant matrix rate are governed by special rules.
The driving force that determines the level of the interest rate matrix is the weighted average of long-term (approximately ten-year) government bond yields for the five currencies that compose the SDR basket. The relative weighting for the currencies is the same as the weighting for the interest rate on holdings of SDRs, but the instruments that compose the basket for the matrix rates are not the same as the instruments that compose the Fund’s basket.

The weighted average of the five interest rates that enter into the calculation of the matrix rates is calculated every six months, based on the average of daily rates for the months of December and June. The resulting weighted average is compared with the similar average at the time of the most recent change. If there has been a new change of at least 0.5 percent, the interest rates are adjusted by the amount of the change, after rounding to the nearest 0.05 percent. The adjusted rate then takes effect on January 15 or July 15, as the case may be. This new procedure began with a first calculation as of the end of 1984. The comparison was made with the minimum interest rates in force on October 15, 1983, which involved the highest rates for the category of relatively rich countries and descending rates for the other two categories.

The revised Arrangement that took effect on October 15, 1983 did not make it clear whether the weighting for matrix rates was linked to the SDR basket as of the effective date of this revision or whether the link was to the SDR basket as composed from time to time. The latter course has been chosen, and it was followed to take account of the revised SDR basket that took effect on January 1, 1986.

Annex B to the Arrangement, which was incorporated in the first text of the Arrangement, has dealt with a standard form of notification to the OECD Secretariat by a participant for distribution to other participants. The notice contained information relating to transactions or lines of credit for which the terms of credit were regarded by the notifying participant as derogations from the Arrangement. The value of an individual project or contract was included in the information to be notified, and the value had to be classified within a scale of categories denominated in SDRs. The SDR was used as a neutral expression that avoided reference to a specific currency and exact amounts of it in notifications. For example, instead of specifying that the amount of an item of potential business was US$25 million, competing export credit agencies would be informed that the amount was within a numbered category, which meant a range of SDR 20
million to SDR 40 million. The original ten categories were retained when the Arrangement was revised with effect as of December 1, 1982. In 1985, however, the number of categories was increased to 15, primarily because of the need for greater precision in the classification of transactions exceeding SDR 40 million, all of which had been grouped in category X.

Currencies

Surveillance over Exchange Rate Policies

The Fund has adopted three published decisions on surveillance over the exchange rate policies of members since the publication of Pamphlet No. 40 in 1983. The basic decision on surveillance provides that the Executive Board shall review annually the general implementation of the Fund’s surveillance. In addition, the Executive Board must review the basic decision on surveillance at intervals of two years and at such other times as consideration of it is placed on the agenda of the Executive Board. The three new decisions are reproduced in Appendix B. Some of the main propositions included in the decisions are summarized below. They are mostly procedural rather than substantive law, but substantive law, it has been said, tends to be secreted in the interstices of procedure in primitive societies.

1. The decisions emphasize the desirability of the symmetrical treatment of members with smaller economies or members using the Fund’s resources and the issuers of major currencies. Many of the international economic difficulties of recent years have been associated with the pronounced swings in exchange rates between major industrial countries and with repercussions on the rest of the world of the low levels of economic activity and high interest rates prevailing in major industrial countries. According to the view of many Executive Directors, these developments resulted from domestic policy stances in major industrial countries that, according to these Directors, did not sufficiently promote the convergence of favorable economic conditions and that failed to take account of the implications of these stances for other countries and for the international monetary system as a whole. “Most Directors felt that this failure to integrate international interests, rather than any deliberate attempt to manipulate exchange rates or the international monetary system, was the real problem.”

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The language of the sentence quoted above recalls Article IV, Section 1(iii), which imposes on members the obligation to avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members.

The implication of the last sentence of the preceding paragraph is that the manipulation referred to in Article IV, Section 1(iii) is not a breach of the obligation imposed by that provision unless there is a kind of mens rea. A judgment on whether or not there is a breach cannot be determined by objective criteria alone. Even if intent were absent, economic conditions might be the same as if there had been intent. For this reason, the deduction was drawn ("[t]herefore") that "the Fund had to form a view on the domestic policies needed to foster a smooth working of the system and had to attempt to persuade its members to follow such policies." The Fund must use its influence to eliminate unfavorable economic conditions and must not confine itself to the elimination of breaches of obligation.

The Fund’s duty under Article IV, Section 3(a) is indeed twofold: not only to oversee the compliance of members with their exchange rate obligations but also to “oversee the international monetary system in order to ensure its effective operation.” That those duties may necessitate a view on the domestic policies of members has been made clear in the Fund’s basic decision on surveillance:

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

2. The Fund should warn against the dangers of protectionism. The coverage and analysis of trade policy matters should be expanded in Article IV consultation reports, without trespassing on the jurisdiction of the General Agreement on Tariffs and Trade (GATT). The focus in Article IV reports should be on the impact of a member’s trade measures.
on domestic adjustment and the exchange rate and on the economy of the member’s trading partners.

3. Article IV consultation reports should deal extensively with policies on, and developments in, external indebtedness.

4. Article IV consultations should be scheduled with improved regularity, particularly for members whose economies have a substantial impact on other countries, members whose programs are supported with the Fund’s resources, and members in situations about which there are doubts about medium-term economic stability. For most of the members for which a stricter schedule should apply, the objective should be an interval between consultations of no more than 12 months, with a grace period of perhaps 3 further months. For members not on a stricter schedule, the maximum limit should be two years, although a member in this group would be entitled to request annual consultations. The experiment of semiannual reviews or miniconsultations should be tried if a member’s economic situation was changing rapidly.

5. Military hostilities would warrant a delay in holding consultations, but the case for delay for political reasons, such as elections, because a member was reformulating its economic policies, was less clear. If delay occurs, it should be fitted into the grace period of three months whenever possible.

6. To ensure the symmetrical or evenhanded treatment of all members and to reflect the concern expressed about the possibility of competitive devaluations, an experimental procedure has been endorsed of alerting the Executive Board to all large changes in real effective exchange rates (that is, to large changes in competitiveness based on exchange rates), whatever a member’s exchange arrangement may be. The changes are those that occur in real terms (that is, in the value of a member’s currency against a weighted average of the currencies of trading partners), whether in the form of depreciation or appreciation, and whether these changes take place at a single stroke or are the result of cumulative changes over time. The amount of the change in exchange rate for a member’s currency ("the threshold") that is the subject of notice to the Executive Board is 10 percent or more in the period since the latest occasion on which the Executive Board discussed the member’s exchange rate policy. In most cases, the latest occasion would be the last Article IV consultation. Reports by the Fund’s staff on Article IV consultations provide the necessary data and describe the indicators of competitiveness for a
member that are used in judging whether the threshold has been overstepped. This new procedure is in addition to pre-existing procedures for notifying the Executive Board of changes in nominal exchange rates.

For the purpose of notices on changes in the real effective exchange rate, the focus of the index is on the comprehensive international cost and price competitiveness of each member. An increase in the level of the index shows a loss in comprehensive cost and price competitiveness. A notice is not in itself evidence that an exchange rate is becoming inappropriate, nor is the absence of a notice in itself evidence that an exchange rate continues to be appropriate. Similarly, a notice, or the absence of a notice, does not in itself connote that a breach of any of the obligations included in Article IV has occurred or that these obligations are necessarily being observed. Notices may include an analysis and appraisal of the change. A notice may induce the Managing Director as Chairman of the Executive Board to place the notice on the agenda of the Executive Board for discussion. An Executive Director is entitled to have any item, including a notice, placed on the Board's agenda. According to the Fund's Annual Report 1985, notices had not led to discussions by the Executive Board, although they had often served to sharpen the focus of discussion of exchange rate policy when the Executive Board was conducting an Article IV consultation or considering a request for use of the Fund's resources shortly after a notice had been issued.

Three indices are used for the calculation of real effective exchange rates. Different indices apply to three groups of countries: industrial countries; countries, including the first group, in which the share of manufactures in total production and exports is sizable and for which the relevant data are readily available; and countries that are mainly producers and exporters of primary commodities. If reliable data for making the calculation of real effective exchange rates are lacking for a country in this third group, the calculations are based on the nominal effective exchange rate. The indices are subject to refinement as experience is gained. As part of the monitoring process, the Fund's staff provides the Executive Board with quarterly reports containing charts and tables of data on indicators of real effective exchange rates. The period covered by the indicators extends over several years, in order to permit the examination of changes in a medium-term perspective.

7. The monitoring process outlined above is an aspect of the Fund's duty to form a view on the appropriateness of members' exchange
rate policies. It is often difficult to determine with quantitative precision the extent to which an exchange rate is “out of line,” but if the Fund concludes that a rate has this characteristic, “the Fund must express that view in the first instance to the authorities of the countries directly involved.” This statement probably means that the Managing Director or staff communicates this view to the authorities so as to get their reaction before the issue is taken up with the Executive Board.

8. Surveillance is not confined to the Fund’s consultations with individual members; it must be conducted multilaterally as well so that global issues can be examined. The Executive Board’s debates on the World Economic Outlook and the Fund’s more active role in looking for solutions to the problems of external debt and protectionism in multilateral contexts are among the opportunities that are mentioned for pursuing a multilateral approach to surveillance.

9. A medium-term approach, on balance of payments prospects in particular, has been endorsed, so that surveillance is not confined to present conditions and short-term expectations.

10. The subject of objective indicators as aids to an examination of the appropriateness of exchange rates or even as conclusive or presumptive evidence of the necessity for adjustment, including possibly a change in exchange rate, was discussed by the Interim Committee of the Board of Governors on Reform of the International Monetary System and Related Issues (the Committee of Twenty) in connection with the return to a more flexible par value system. Annex 1 to the Outline of Reform in the Committee’s report, which recorded the state of the discussion reached but did not express agreed views of the Committee, dealt with possible indicators based on movements in reserves. The Committee proposed, however, that during “the interim period,” which was thought to be the period before return to a par value system, “an immediate step” could be 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.

The Board of Governors endorsed this proposal in its Composite Resolution No. 29-10, dated October 2, 1974.

The subject of objective or other indicators has arisen again in the review of surveillance. Opinions on them have been divided, but the staff
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has been urged to adopt an experimental approach in studying the concept and exploring it with interested authorities.

11. The procedure of "enhanced surveillance" has emerged, by which the Fund can monitor a member's economic policies more frequently than under ordinary surveillance procedures when a member is no longer using the Fund's resources and the member has entered into a multi-year rescheduling arrangement with commercial banks to which it is indebted. The procedure is designed to facilitate a member's transition to normal access to commercial financing. The Managing Director's summing up of the Executive Board's 1985 review of the implementation of surveillance procedures includes the following principles for enhanced surveillance:

(1) The Fund should be selective in acceding to requests for enhanced surveillance. Some Executive Directors cautioned against the Fund’s involvement in arrangements for this procedure over too long a period.

(2) Some Executive Directors considered the procedure to be appropriate mainly for countries in which strong adjustment policies were well under way.

(3) The Fund would continue to consider the endorsement of a member's adjustment program in the context of a stand-by arrangement or an extended arrangement as the normal means of providing the necessary signal to commercial banks and other sources of finance.

(4) Most Executive Directors considered that the release of the staff's consultation reports to banks would be acceptable as a feature of enhanced surveillance, if the member requested this service and if the service was necessary for the multi-year restructuring to take place.

(5) It was emphasized that the staff's reports provided to commercial banks under this procedure should not be, and should not seem to be, signals by the Fund that the commercial banks should or should not act in any particular way under their restructuring agreements. Commercial banks should take full responsibility for their country-risk assessments.

(6) The Fund itself (that is, the Executive Board) should not be seen as either formally endorsing a member's policies or intervening too deeply in the relations between a member and commercial banks.

The Managing Director, in a speech of May 10, 1985, has provided further information about enhanced surveillance. The relevant portions of his speech are reproduced in Appendix C, as are the Chairman's summing up of the discussion of the role of the Fund in assisting members with commercial banks and official creditors at the Executive Board’s
meeting on September 4, 1985, and the Executive Board’s decision of March 12, 1986.

**Surveillance: International Reports**

The subject of surveillance has been examined in some international reports, which, like the Fund’s reviews of the principles and procedures of surveillance, are directed toward improving the effectiveness of surveillance. The Deputies of the Group of Ten have submitted to their Ministers and Governors a report, dated June 1985, entitled *The Functioning of the International Monetary System.* The Deputies justify their view of present exchange arrangements as constituting a floating exchange rate system even though most countries maintain some form of pegging. Indeed, out of an abundance of caution, members insisted that the general authorization to adopt exchange arrangements of their choice under the Second Amendment should refer specifically, but without limitation, to pegging: “(i) the maintenance by a member of a value for its currency in terms of the special drawing right or another denominator, other than gold, selected by the member, or (ii) cooperative arrangements by which members maintain the value of their currencies in relation to the value of the currency or currencies of other members.”

The Deputies consider the system a floating one because the main currencies float separately or jointly against each other. These currencies, though floating, are used to invoice and finance the bulk of world trade, are the basis for most of the Eurocurrency markets, and dominate foreign exchange trading. Three fourths of the world’s trade and most of the world’s invisible and capital transactions are conducted at floating exchange rates. Furthermore, most countries, whatever their formal exchange arrangements, have shown a greater willingness to let their exchange rates vary to prevent or to correct balance of payments disequilibrium than under the par value system.

In these circumstances, the report draws attention to the obligations of members under Article IV, Section 1 of the Fund’s Articles, assesses floating exchange rates, discusses proposals to improve exchange rate stability (including target zones for exchange rates), and devotes a whole chapter to “strengthening international surveillance.”

The report refers to “symmetry,” “evenhandedness,” and “uniformity” in the exercise of surveillance, pointing out that these concepts do not mean that the prescriptions must be the same for all members. The role
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of these concepts in the Fund’s law and practice has been examined elsewhere. The report makes proposals on “Article IV surveillance,” which is viewed as consultations of the Fund with individual members, and “multilateral surveillance.”

The Ministers and Governors of the Group of Ten, having considered their Deputies’ report at a meeting in Tokyo, issued a statement on June 21, 1985, in which paragraphs 5 and 6 declared that:

5. We have considered a proposal for the introduction of target zones for exchange rates as more formal and binding indicators for the conduct of macroeconomic policies. In this respect, an interest has been expressed by some of us for having the technical aspects of target zones further explored at an appropriate time. The majority of us, however, consider that a move to target zones would not offer a practical way forward in present circumstances.

6. We agree that the achievement of greater exchange rate stability requires a general strengthening of international surveillance, and have considered the recommendations in the Deputies’ report to improve the effectiveness of IMF surveillance. These include suggested innovations on the level at which consultations should take place and the arrangements for consideration of their outcome, the development of “enhanced” surveillance in certain cases, the increased use of special or supplemental consultations, and the introduction of strengthened arrangements for multilateral surveillance. We believe that the implementation of suggestions on these lines would sharpen the focus of surveillance, enabling the IMF to deal more effectively both with the domestic problems of individual members and with problems of systemic relevance. We recommend that the IMF Executive Board consider the report’s specific proposals in these areas with a view to their early implementation, as appropriate.

The Report of the Deputies of the Intergovernmental Group of Twenty-Four on International Monetary Matters, dated August 21, 1985 and entitled The Functioning and Improvement of the International Monetary System, includes chapters on The Functioning of the Present Exchange Rate System (Chapter IV) and on Surveillance (Chapter V). The report concludes that present exchange arrangements have been particularly hurtful to the interests of developing countries. The report though is sympathetic to the establishment of target zones for major currencies and states that the proposal needs further study. Surveillance in accordance with Article IV should be the framework for policy coordination among members to improve the performance of exchange arrangements and the international monetary system.

The report states that the Fund’s influence has been stronger on
members using the Fund's resources than on the major industrial countries. This disparity is undesirable even if a formal distinction is made between consultations under Article IV and adjustment problems associated with the use of the Fund's resources. Surveillance should be strengthened so as to reduce this asymmetry. Surveillance should be directed toward the international adjustment process and should not be confined to exchange rate policies. This change in emphasis would be in accordance with Article I(ii). Various recommendations for this purpose include the aim of finding "a set of outcomes or 'objective indicators' or 'targets,' that appear to be sustainable in the medium-term and desirable to all parties."83 Much of the discussion of procedures for encouraging adjustment are reminiscent of the corresponding sections of the Committee of Twenty's Outline of Reform.84 On enhanced surveillance, the recommendations of the Deputies of the Group of Twenty-Four are close to the practice of the Fund as it has evolved to date.

The Interim Committee's communiqué of October 7, 1985 referred to the reports by the two groups of Deputies as follows:

10. The Committee had a preliminary exchange of views on the reports on the international monetary system presented by the Group of Ten and the Group of Twenty-Four. It was agreed to request the Executive Board to study the issues raised in these reports with a view to facilitating a substantive consideration by the Committee at its next meeting. The Committee welcomed the commitment of its Chairman to communicate with the Chairman of the Development Committee, with a view to seeing to what extent arrangements could be made for cooperation on matters pertaining to development.85

The Interim Committee's communiqué of April 10, 1986 contained the following paragraphs:

5. Concerning the exchange rate system, the Committee agreed that the flexibility with which the system had operated had enabled the world economy to adapt to a number of major disturbances; however, the variability of exchange rates and the longer-term misalignments that had emerged remained a source of concern. It was agreed that, if better exchange rate performance were to be achieved on a durable basis, it would be of the essence that economic policies be conducted in a sound and mutually consistent way and that exchange rate considerations should play their part in those policies. The Committee asked the Executive Board to consider further whether there are modifications in the exchange rate system which could contribute to enhancing exchange rate stability and the mutual consistency of economic policies without sacrificing the essential flexibility of the system.
6. The Committee reconfirmed the key role that Fund surveillance needs to play in the functioning of the international monetary system. The Committee noted that several proposals presented by the Group of Ten and the Group of Twenty-Four to strengthen surveillance are being implemented. To improve the multilateral setting for surveillance, the Committee asked the Executive Board to consider ways in which its regular reviews of the world economic situation could be further adapted to improve the scope for discussing external imbalances, exchange rate developments, and policy interactions among members. An approach worth exploring further was the formulation of a set of objective indicators related to policy actions and economic performance, having regard to a medium-term framework. Such indicators might help to identify a need for discussion of countries' policies. The Committee noted that increased emphasis would be given in the World Economic Outlook to policy interactions among industrial countries in order to strengthen the basis for assessing the international repercussions of the policies and objectives of the major industrial countries, and also to help promote the further development of recent initiatives to enhance policy coordination among these countries. The Committee stressed the importance of taking into account the views of the whole Fund membership in this multilateral discussion. In addition, the Committee asked the Fund to consider further the ideas in the Group of Ten and Group of Twenty-Four reports regarding the strengthening of the consultation process.

The Executive Board's reactions to the reports of the two groups of Deputies, in the light of the 1986 review of surveillance, appear in the Fund's Annual Report for 1986. The relevant pages are reproduced in Appendix D.

**Intervention**

Under Article IV, Section 3(b), the Fund must adopt "specific principles for the guidance of all members with respect" to their exchange rate policies. The Fund has adopted three specific principles, of which two deal explicitly with intervention in exchange markets:

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

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

The verb "should intervene" in Guideline B is hortatory and not mandatory, as is evident from the verb "shall avoid" in Guideline A.
A. A member shall avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members.87

"Disorderly conditions" are not defined in Guideline B, and have not been defined by the Fund since adoption of the formulation.88 Disruptive short-term movements in the exchange value of a currency may be evidence of the existence of disorderly conditions, but there may be other evidence of such conditions, which need not themselves be accompanied by disruptive short-term movements in the exchange value of a currency. The adjective "disruptive" also is undefined. It has been left to members to decide whether disorderly conditions exist and whether members "should" intervene. A member is not required to seek the approval or advice of the Fund on whether or not to intervene.

In its surveillance over the exchange rate policies of members, the Fund can decide whether or not a member is acting in accordance with the guidelines. A finding that a member is not acting in accordance with them is not in itself equivalent to a finding that the member is failing to comply with its obligations under Article IV, Section 1 or under another provision, but the Fund may take nonobservance of the guidelines into account in deciding whether there is a breach of obligation. Hitherto, the Fund has not made a finding that a member is not observing the guidelines or is failing to comply with its obligations under Article IV, Section 1 or under any other provision of Article IV.

It is not only the absence of intervention that may suggest the need for examination by the Fund under Guideline B or C. Intervention may give the signal for examination under Guideline A. The Fund's basic decision on surveillance sets forth the circumstances that may indicate the need for a special discussion between the Fund and a member, although without any presumption that the guidelines or the member's obligations are being flouted:

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

(i) protracted large-scale intervention in one direction in the exchange market;... 89

A Statement on International Monetary Undertakings was attached to the communiqué issued as a result of the Summit Meeting of the Heads of
State and Government of seven countries at Versailles on June 4–6, 1982. Four of the seven paragraphs of the Statement read as follows:

2. We attach major importance to the role of the IMF as a monetary authority and we will give it our full support in its efforts to foster stability.

3. We are ready to strengthen our cooperation with the IMF in its work of surveillance, and to develop this on a multilateral basis taking into account particularly the currencies constituting the SDR.

4. We rule out the use of our exchange rates to gain unfair competitive advantages.

5. We are ready, if necessary, to use intervention in exchange markets to counter disorderly conditions, as provided for under Article IV of the IMF Articles of Agreement.

Paragraph 5 attributes the readiness to intervene to counter disorderly conditions to Article IV without further precision. If the reference is to the principles for the guidance of members adopted under Article IV, Section 3, members are expected to intervene (“should intervene”), but if the reference is to Article IV, Section 1(iii), members have an obligation. The verbs in Section 1(iii) and (iv) are mandatory, because these provisions deal directly with exchange rates, in contrast to the verbs in Section 1(i) and (ii), in which the verbs are hortatory (“endeavor,” “seek”) because they do not deal directly with exchange rates and because they involve a wider range of policies, including domestic policies. The further question that arises is why Guideline B is expressed in hortatory language if the guideline derives from the mandatory language of Article IV, Section 1.

Article IV, Section 1 is formulated as follows:

General obligations of members

Recognizing that the essential purpose of the international monetary system is to provide a framework that facilitates the exchange of goods, services, and capital among countries, and that sustains sound economic growth and that a principal objective is the continuing development of the orderly underlying conditions that are necessary for financial and economic stability, each member undertakes to collaborate with the Fund and other members to assure orderly exchange arrangements and to promote a stable system of exchange rates. In particular, each member shall:

(i) endeavor to direct its economic and financial policies toward the objective of fostering orderly economic growth with reasonable price stability, with due regard to its circumstances;
(ii) seek to promote stability by fostering orderly underlying economic and financial conditions and a monetary system that does not tend to produce erratic disruptions;

(iii) avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members; and

(iv) follow exchange policies compatible with the undertakings under this Section.

As a result of the Versailles Summit, a Working Group on Exchange Market Intervention was established, consisting of officials from the finance ministries and central banks of the countries participating in the 1982 Summit Meeting, with Philippe Jurgensen as Chairman. In March 1983, the Working Group issued a report entitled Report of the Working Group on Exchange Market Intervention (the Jurgensen report), which was intended to bring about greater understanding of the motives, methods, and effects of intervention.

On April 29, 1983, the Finance Ministers and Central Bank Governors of the Summit countries, and representatives of the European Community, met and issued a statement in which they announced that they had reached the following agreement:

a. The achievement of greater exchange rate stability, which does not imply rigidity, is a major objective and commitment of our countries.

b. The path to greater exchange rate stability must lie in the direction of compatible mixes of policies supporting sustainable noninflationary growth. This will be the primary objective of a strengthened multilateral surveillance as agreed in Versailles.

c. In the formulation of our domestic economic and financial policies, our countries should have regard to the behavior of our exchange rates as one possible indication of need for policy adjustment. Close attention should also be given to the interactions and wider international implications of policies in each of our countries.

d. Under present circumstances, the role of intervention can only be limited. Intervention can be useful to counter disorderly market conditions and to reduce short-term volatility. Intervention may also on occasion express an attitude toward exchange markets. Intervention will normally be useful only when complementing and supporting other policies. We are agreed on the need for closer consultations on policies and market conditions; and, while retaining our freedom to operate independently, are willing to undertake coordinated intervention in instances where it is agreed that such intervention would be helpful.91
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On January 17, 1985, the Ministers of Finance and the Central Bank Governors of the Group of Five major industrial countries (France, the Federal Republic of Germany, Japan, the United Kingdom, and the United States) held a meeting as one of the series of periodic consultations among these countries on economic and financial matters of common interest. The Managing Director attended for a discussion of the economic policies and prospects of these major industrial countries. The Ministers and Governors expressed their commitment to work toward greater exchange market stability. In pursuit of this objective, they mentioned various intentions, one of which was that

...in light of recent developments in foreign exchange markets, [the Ministers and Governors] reaffirmed their commitment made at the Williamsburg Summit (the seven-nation economic summit held in 1983) to undertake coordinated intervention in the markets as necessary.

The communiqué of the Ministers and Governors of the Group of Ten, issued in Tokyo on June 21, 1985, included the following statement as part of paragraph 4:

(v) The role of exchange market intervention can only be a limited one, as intervention will normally be useful only when complementing and supporting other appropriate policies. However, intervention can be useful to counter disorderly market conditions and reduce short-term volatility. Countries should be willing to undertake coordinated intervention on occasions when it is agreed that it would be helpful.

This succession of muted statements on intervention did not prepare even well-informed observers for one of the conclusions in the announcement by the Ministers of Finance and Central Bank Governors of the Group of Five on September 22, 1985. The participants in that meeting stated that they had convened within the context of their agreement to conduct mutual surveillance and in preparation for the forthcoming Annual Meetings of the Boards of Governors of the Fund and the World Bank in Seoul. The Ministers and Governors reviewed progress and prospective difficulties, the steps that each country needed to take, and their intentions. Paragraph 18 of the Announcement set forth a conclusion that was taken to portend a greater willingness to embark on intervention to bring about a concerted result:

18. The Ministers and Governors agreed that exchange rates should play a role in adjusting external imbalances. In order to do this, exchange rates should better reflect fundamental economic conditions than has been the case. They
believe that agreed policy actions must be implemented and reinforced to improve the fundamentals further, and that in view of the present and prospective changes in fundamentals, some further orderly appreciation of the main non-dollar currencies against the dollar is desirable. They stand ready to cooperate more closely to encourage this when to do so would be helpful.  

The Assistant Secretary of the U.S. Treasury for International Affairs stated on October 23, 1985 that intervention had taken place:

In accordance with our long-stated willingness to undertake coordinated intervention in instances where it is agreed that such intervention would be helpful or necessary, such intervention has been undertaken. While I cannot comment on the nature, timing, or amounts, I can assure you that there has been a high degree of cooperation and coordination among the various monetary authorities. We have developed clear, detailed procedures on how intervention operations might be conducted. We have not sought to establish target zones or target exchange rates. We are determined, however, to demonstrate our seriousness of intent over a prolonged period—through policy actions as well as exchange market operations—to help accelerate the convergence of economic performance among the major countries and further strengthen non-dollar currencies.  

**Some Reflections on Legal Analysis**

The legal character of the Guidelines, in particular Guideline B, has been discussed above. The Guidelines have a clear legal basis, because they are specific principles for the guidance of all members with respect to their exchange rate policies that the Fund must adopt to fulfill its functions under Article IV, Section 3(a). Under that provision, the functions of the Fund are to oversee the international monetary system and “the compliance of each member with its obligations under Section 1” of Article IV. But those obligations, though all have a legal basis and bind members as states, are not formulated in the same style. Under Article IV, Section 1, a member has forcefully stated obligations to collaborate in accordance with the introductory language of the provision and to act in accordance with Section 1(iii) and (iv). Obligations of collaboration are imprecise and might be classified by some legal scholars as “soft law” for that reason. The obligations of Article IV, Section 1(i) and (ii) are even more obviously “soft law” for the further reason that the obligations are formulated in tentative language. A member is instructed not to do, but to try to do, certain things.

Other legal questions arise in connection with the various communiqués mentioned above. The participants in the meetings that issue these
communiqués—Heads of State or Government, Ministers of Finance or Governors of Central Banks, or Deputies—often use the language of agreement. The "agreements" are understandings not regarded as having the legal character of undertakings that bind states, even if the understandings purport to give effect to obligations under the Articles as seen by the participants that join in the understandings. The obligations under the Articles bind members as states, but the understandings expressed in communiqués do not conform with domestic requirements for the assumption of internationally binding agreements. The understandings are intended to express the intentions of the issuers of the communiqués on policies, but without considering these intentions to be legal obligations. If an understanding is not observed in practice, a country or government cannot be charged with a breach of obligation. This conclusion does not mean that the issuers enter into their "agreements" without a serious intention to observe their understandings in good faith.

The understandings expressed in communiqués raise the issue whether the understandings are "soft law" and whether "soft law" is entitled to be considered law at all. Ultimately, the issue is what is meant by "law," particularly in relation to public international law. The sources of public international law are now being rethought, as demonstrated by one author, who has written:

This brings us to a third school of thought which has emerged in reaction to the problems concerning the sources of international law. This school of thought was to a large extent equally prompted by the questions involved in the legal nature of the General Assembly resolutions, but its tenets also apply to other documents whose legal status is unclear. In this respect it constitutes, therefore, a more systematic approach. For reasons of convenience this school can be called the "soft-law" approach, a term coined by McNair. The three approaches mentioned in this chapter overlap to a certain extent. Just like the other two, this third school is first of all faced with the question of classifying or explaining the new developments and phenomena in terms of the traditional sources. The term "soft-law," however, bears out its main focus and distinguishing feature. For authors belonging to this third group do not make a black-and-white distinction between law and non-law. After testing a new type of instrument on the basis of the criteria of the traditional sources, they conclude that these instruments cannot be considered as "full-fledged" rules of international law. On the other hand, they stress that these instruments fulfil at least some, if not a great number of the criteria required for rules to be considered rules of international law and cannot therefore be simply put aside.
as non-law. In other words, they acknowledge that there exists a considerable “grey area” of “soft-law” between the white space of law and the black territory of non-law. Simultaneously, they make the salient point that the “grey area” may greatly affect the white one and explain, sometimes in considerable detail, in what ways “soft-law” can have legal effects. In doing so the “soft-law” approach more or less substantiates Friedmann’s earlier perception of a development towards a “far greater variety of sources of international law” which, according to him, moreover, “may vary greatly in intensity.”

The same author notes that the approach explained above has now gained a considerable number of supporters. The prevalence of soft law, it might be added, is particularly noticeable in the economic relations of states.

Another question that arises is whether the subject matter of the understandings is within the purview of the “international monetary system” as a legal concept. The system became a legal concept under the Second Amendment. Not only is the international monetary system now mentioned in the Articles, but in addition, functions are conferred on the Fund in relation to the system. In a discussion of the concept and its relationship to the Fund and international monetary law, the following alternative definitions of the system have been advanced:

3. A persuasive definition of the international monetary system, at least for some purposes, is that it consists of the rules governing the relations of countries through their balances of payments. Normally, the monetary authorities of a country are in charge of these relations. The monetary authorities are the treasury, central bank, stabilization fund, or other similar fiscal agency of a country. An alternative definition is that the international monetary system consists of the rules governing the adjustment of balances of payments and the financing of imbalances that monetary authorities are legally bound to observe or consider themselves morally bound to observe.

Nobody would doubt that all aspects of exchange rates, including intervention, on which international agreements properly so-called or understandings are reached, form part of the “international monetary system.” The question whether an informal agreement like the OECD Arrangement on Guidelines for Officially Supported Export Credits, which was discussed earlier in this pamphlet, must be classified as falling within the international monetary system would be more difficult to answer.

Multiple Currency Practices: Capital Transactions

In Pamphlet No. 40, it was recalled that, throughout the history of the Fund, there had been no resolution of the legal problem whether a
special rate of exchange confined exclusively to capital transactions is subject to the regulatory jurisdiction of the Fund under Article VIII, Section 3. The problem is whether Article VI, Section 3, which authorizes members to control capital transfers, has overriding effect notwithstanding Article VIII, Section 3, which requires a member to obtain the Fund's approval of multiple currency practices without any express exception for those practices that are confined to capital transfers. The staff of the Fund has worked with the presumption that these latter practices are subject to Article VIII, Section 3 and require the approval of the Fund to make them consistent with the Articles. The Fund's basic decision on the effects of the Second Amendment on the law relating to multiple currency practices avoids the problem.

The problem as stated above assumes that special exchange rates confined to capital transfers are multiple currency practices within the meaning of Article VIII, Section 3 but that possibly they may be authorized by the Articles under Article VI, Section 3 without the necessity for approval by the Fund. The problem might also be formulated as one of determining whether such exchange rates are solely multiple currency practices under Article VIII, Section 3 or solely "controls necessary to regulate capital movements" under Article VI, Section 3. The Fund has treated the problem as if it were one of establishing the primacy of Article VIII, Section 3 or Article VI, Section 3 on the assumption that the exchange rates came within the scope of both provisions. In the absence of a decision by the Fund of the necessity for approval of the exchange rates, courts should conclude, if the issue were to arise, that these rates are maintained or imposed consistently with the Articles, whatever view the courts may take on the formulation of the problem.

The Fund's Annual Report on Exchange Arrangements and Exchange Restrictions for 1985 states that the Executive Board discussed the problem of jurisdiction in early 1985, but again did not take a view, "leaving the matter open for further consideration." The Executive Board agreed, however, that members should continue to provide the Fund with specific and full information on capital controls and multiple currency practices applicable solely to capital transfers. The Fund would continue to assess the economic consequences of these controls and practices in the context of its surveillance over the exchange rate policies of members. The report continues as follows:

The experience of the Fund membership with regard to practices that segment
foreign exchange markets precisely on the basis of current and capital transactions has been limited; only six countries presently maintain multiple currency practices that are identified as relating solely to capital transactions. In most of these instances, these practices have not taken the form of a separate exchange rate for capital flows in general, but rather for specific components of the capital account, and they have served as an adjunct, and not as an alternative to, quantitative controls on other forms of capital transactions. Furthermore, the spreads have generally been maintained at a more or less steady depreciated rate over extended periods of time, or have varied mainly in response to nonbalance of payments factors, or were subject to infrequent discretionary change, all of which indicate that these practices have played a limited "buffering" role for variations in capital movements.

It may be that the issue of jurisdiction cannot be resolved by normal textual analysis, because textual considerations in support or in denial of jurisdiction balance each other. The issue then would have to be resolved by a choice among what are thought to be the objectives of the Articles. For this reason, the problem of jurisdiction has always been discussed in terms of the economic usefulness of special exchange rates confined to capital transfers. If such exchange rates are considered useful, members often tend to conclude that they have not subjected the practice to international regulatory jurisdiction.

Some Legal Consequences of Fluctuating Exchange Rates

Problems of Choice

When it was necessary to express monetary amounts for some legal purpose while the par value system was in force, it was often considered satisfactory to express the amounts in the domestic currency of the country in which it was likely that calculations would be made. This technique was acceptable even if the circumstances necessitating the calculation included some relationship—connecting factors, to use the language of private international law—with more than one country. Since the disappearance of the par value system, this technique is not always considered satisfactory. Reasons of policy, including fairness, may make it more satisfactory to express amounts in a foreign currency. If a foreign currency is deemed preferable, it is necessary to determine how the currency is to be selected. Furthermore, it may be necessary to select the rate of exchange at which amounts expressed in the foreign currency are to be translated into the domestic currency of the country in which a calculation is likely to be made. The two questions—the choice of
currency and the choice of exchange rate—are discussed below in relation to the judgments of courts. A practice of the Securities and Exchange Commission of the United States is discussed as an example of another legal purpose that makes such choices necessary.

**Judgments.** The fluctuation of exchange rates has produced numerous changes in national law and is likely to produce further changes. One of the most important changes is in the law relating to the currency in which judgments are expressed and the date as of which exchange rates are selected if it is necessary to translate one currency into another for the purpose of discharging or executing judgments expressed in a foreign currency. In English law, the final appellate tribunal, the House of Lords, changed the earlier law by deciding, in *Miliangos v. George Frank (Textiles) Ltd.*,107 first, that judgments can be expressed in a foreign currency if appropriate to the plaintiff’s claim. Second, if the judgment is performed in sterling, whether or not by execution under an order of the court, the exchange rate at which the foreign currency is to be translated into sterling is the rate on the date of performance or the date of the order for execution and not the rate on the date when the claim arose (the so-called “breach-date” rule).

The new principles were established as a consequence of the fluctuation of currencies, and in particular the depreciation of sterling, as well as the desire to do justice to claimants who might be treated inequitably under the earlier principles that judgments could be expressed only in sterling and that, if translation from a foreign currency was necessary, translation was to be made at exchange rates in accordance with the breach-date rule.

A substantial body of judicial law has developed rapidly as a consequence of the *Miliangos* case; the phenomenon has been described as a “moving staircase” of judicial development. Much of the new law is discussed in the earlier Pamphlets of the Fund in this series. The *Miliangos* body of law has been followed in other jurisdictions and has prompted inquiry into the efficacy of the new principles in jurisdictions in which the principles are not yet endorsed.

If national law provides that judgments can be expressed only in the currency of the forum, the choice of exchange rate is likely to be the rate under the breach-date rule, because substantial changes in exchange rates were less likely under the par value system. If national law permits judgments to be expressed in a foreign currency when appropriate, the way is open to the principle that the exchange rate as of a later date would
be more equitable, such as the date of discharge or the date of execution of a judgment. Even if judgments can be expressed only in the domestic currency, the issue has arisen whether translation in accordance with an exchange rate as of a date later than the date of breach should be chosen. The breach-date rule may be supplanted, therefore, whether or not judgments can be expressed in a foreign currency.

Three reports that examine the law relating to these two problems of choice have appeared over the span of a few years. In England, the statutory Law Commission in October 1983 issued a detailed report on the law and related procedures entitled Private International Law: Foreign Money Liabilities. The major purpose of the report was to determine whether legislation should be recommended that would change the law on foreign money liabilities that had grown up largely as a result of the Miliangos decision. The Commission has not recommended legislative changes. The report concludes, in Part VI, with 7 pages of summarized conclusions and recommendations, of which 14 relate to the substantive law, 4 relate to interest on judgment debts and arbitral awards in foreign currency, and 19 relate to procedure.

The main conclusions and recommendations on substantive law are as follows:

1. The principle underlying the decision in Miliangos and the consequences which flow from it are greatly to be preferred to the rules which that decision superseded.

2. (a) A plaintiff should not be able to obtain judgment in sterling in the case of the enforcement of a claim which ought properly to be expressed in a foreign currency, but

(b) legislative intervention to secure that result is not necessary, since the matter can appropriately be left to judicial decision.

3. No change is necessary or desirable in the present rule that conversion of a foreign-currency judgment into sterling is to be effected at the date of actual payment or the date on which the court authorises enforcement of the judgment, whichever is the earlier, because in general that rule provides the best practical implementation of the Miliangos philosophy.

4. Parties should continue to be free to agree:

(a) that payment in England and Wales should be made in a particular foreign currency alone (with no option for the debtor to pay in sterling); and

(b) in relation to any currency conversion, the date at which it is to be made or the exchange rate to be applied.
(5) The problem of set-off which arises where the parties' judgments against each other are expressed in different currencies should be resolved:

(a) if a procedure can be introduced whereby neither party's judgment can be enforced without taking account of the other's, by giving judgment for each party in the currency applicable to his claim and directing that the judgments should be subject to such procedure in the event that enforcement of either judgment is subsequently sought; but

(b) in the absence of such a procedure, conversion should be effected at the date of judgment, and judgment given in the currency of the claim of the party whose claim on that basis is the larger.

(8) The present law relating to the conversion into sterling of foreign-currency claims in relation to solvent and insolvent companies and to bankruptcy is satisfactory.

(12) No change should be made in the present rules governing the conversion into sterling of maintenance orders expressed in a foreign currency when such orders are enforced.

(13) (a) The present law that the existence of the right to claim interest is governed by the lex causae is satisfactory.

(b) The present law, whereby when the court exercises its discretion under section 35A of the Supreme Court Act 1981 to award interest, it does so, prima facie, at the rate applicable in the context of the currency of the judgment, is satisfactory.

(c) Where interest is claimed by virtue of a term of the contract, the validity of that term and the rate at which interest is to be paid should continue to be governed by the lex causae (i.e., the proper law of the contract).

(d) The rate of interest on damages should be determined by the application of English law as the law of the forum.

(14) The introduction of a specific rule governing the award of compensation for late payment of a foreign-currency debt would be undesirable in the absence of similar development in the general law relating to damages for late payment of a debt.109

In 1983, the Law Reform Commission of British Columbia issued a thorough report of its own, entitled *Report on Foreign Money Liabilities*. This report examines the jurisprudence of courts in Canada and Canadian legislation, as well as the leading English cases. The report is concluded
in Chapter IX with four recommendations, of which the first three are as follows:

1. Legislation be enacted which reflects the following principles:
   (a) In circumstances where a currency other than the currency of Canada will most truly express a person’s loss or claim and will most fully and exactly compensate him then a court shall order that judgment be entered in a form which states the defendant’s liability in the other currency or the equivalent at the time of payment, in Canadian currency.
   (b) Paragraph (a) should apply mutatis mutandis to arbitration proceedings.

2. Ancillary rules of practice concerning the assertion and enforcement of foreign money claims should be promulgated under the Court Rules Act.
   (b) The form of judgment provided by the rules should be comparable to the following:

   THIS COURT ORDERS that the defendant(s) pay to the plaintiff(s)
   (i) (state the sum in foreign currency in which judgment has been ordered to be entered), and
   (ii) (interest as claimed or, interest pursuant to the Court Order Interest Act)
   or the equivalent, at the time of payment, in Canadian currency, and costs to be taxed.

3. The Court Order Interest Act should be amended by adding a provision to the effect that the court, in the exercise of its discretion as to the rate of interest, should when awarding interest on a judgment stated in a foreign currency, have regard to the foreign interest rates which prevail with respect to that currency.\(^\text{110}\)

The American Law Institute is a professional body, and not an official body like the two Commissions, but the Institute’s Restatements of the Law have had considerable influence on courts in the United States. For some time, the Institute has been undertaking a revision of its Restatement of the Foreign Relations Law of the United States. A Tentative Final Draft was issued on July 15, 1985. For the first time, the Restatement includes three sections on international monetary law: §821 on the exchange rate obligations of members of the Fund; §822 on Article VIII, Section 2(b) of the Fund’s Articles; and §823 on obligations in foreign currency.\(^\text{111}\)

“Comments,” which represent the views of the Institute, and “Reporters’ Notes,” which are not statements of the Institute, are attached to each section. An Introductory Note says of §823 that the section is addressed to the problem of translating foreign currency obligations in litigation in the United States: it is unrelated to the IMF Articles of Agreement.
except in the sense that replacement of the par value system under the original Articles by a system of floating (and often widely fluctuating) exchange rates since 1973 has given increased importance to the problem, and to the need for a governing principle of general application.\textsuperscript{112}

The black-letter text of §823 is as follows:

Obligations in Foreign Currency: Law of the United States

(1) Courts in the United States ordinarily give judgment on causes of action arising in another state, or denominated in a foreign currency, in United States dollars, but they are not precluded from giving judgment in the currency in which the obligation is denominated or the loss was incurred.

(2) If the court gives judgment in dollars in accordance with Subsection (1), the conversion is to be made at such rate as to make the creditor who loses and to avoid rewarding a debtor who has delayed in carrying out the obligation.\textsuperscript{113}

The expository material in this draft Restatement is not as detailed or as scholarly as the reports of the two Commissions. A clause in the passage of the Introductory Note quoted above ("the need for a governing principle of general application") suggests that §823 is more like a recommendation of what the principle should be than the principle that is established law. The Milianges case is relied on to support §823, with the argument that the case disposes of the assertion that judgments by courts in the United States can be expressed only in U.S. dollars is required by Anglo-American common law.

The differences between §823 and the English principles are clear. Subsection (1) is cautious in declaring that courts are not precluded from giving judgment in the currency in which the obligation is denominated or the loss was incurred, while the English principle is that a plaintiff does not have an option to obtain a judgment in sterling if his claim ought properly to be expressed in a foreign currency. The logic of the English principle is that it seeks to avoid injustice to a plaintiff by the judicial transformation of a franc claim, for example, into a sterling claim. Equally, therefore, injustice to the defendant must be avoided by not allowing a plaintiff to make this transformation because it will be beneficial to him and therefore detrimental to the defendant. The Comment gives the plaintiff a qualified option by requiring that a judgment shall be expressed in a foreign currency only if requested by the plaintiff and only if the judgment expressed in this way would best accomplish the objective of subsection (2) (that is, would make the
plaintiff whole and avoid rewarding the delinquent defendant). The Reporters’ Notes are wrong in stating that under the Miliangos principle a plaintiff in English proceedings has the option to claim a foreign currency or sterling. The Reporters have confused the expression of judgments with the defendants’ discharge of judgments. Defendants can pay in the foreign currency of the judgment or the sterling equivalent on the date of payment but will be compelled to pay only in sterling if a court orders enforcement of a judgment, at the rate of exchange prevailing at the date of the order.

English practice does permit the plaintiff an option, but not between claiming sterling and a foreign currency. The Law Commission endorses the principle, as conclusion (B) on procedure, that

Rules of court should provide that a successful plaintiff may, with the leave of the court, obtain and enter judgment in a foreign currency alone (in which case the judgment debtor would not have the option of satisfying the judgment in sterling).\textsuperscript{114}

This rule would not permit a plaintiff to seek a judgment in sterling if his claim is properly a foreign currency claim. He could seek a judgment that would permit discharge only in the foreign currency and not in the sterling equivalent, but for this form of judgment he would have to obtain the leave of the court. It is not clear what the criteria would be for leave, but the report mentions that such requests could increase as a result of the elimination of exchange controls. The report relies heavily on the consideration that there should be some correspondence between substantive and procedural law. As the parties may agree that a sum of money should be paid only in a foreign currency, with no option for the debtor to pay the sterling equivalent, the court should have comparable authority. The report recognizes, however, that plaintiffs may be deterred from seeking leave, because of the difficulties of enforcement in a foreign currency alone. There may be no process of execution in the same currency as that of the judgment, except possibly a garnishee order attaching a debt owed to the defendant, such as a bank account\textsuperscript{115}.

Subsection (2) of §823 contemplates that judgments will be given in dollars in cases in which the judgment could be expressed in a foreign currency according to subsection (1). In other cases, in which a judgment in a foreign currency could not be given under subsection (1), it may be necessary nevertheless to translate a foreign currency into U.S. dollars. In both kinds of cases, a precise date for selecting the rate of exchange at which to make the selection is not given. The broad principle to be
followed is that selection of the rate of exchange should be determined by
the criterion of making the plaintiff whole (restitutio in integrum) and
avoiding any reward to the defendant as a result of delay in performing his
obligation.

The Institute's proposed text would allow a plaintiff who succeeds in
obtaining a judgment expressed in U.S. dollars when his claim is
denominated or his loss is incurred in a foreign currency to avoid the rigor
of the English principle that the judgment date and not the breach-date rule
applies. The Comment foresees cases in which it will be appropriate to
apply the breach-date rule. If, however, the judgment is expressed in a
foreign currency, the defendant may pay either in that currency or in
dollars at the rate of exchange in effect on the date of payment.
Substantially the same principle applies under the Miliangos body of law
in England.

After the Law Commission of British Columbia issued its report, the
Province of Ontario prescribed new rules for the translation of
foreign money claims. The new rules are included in Section 131 of the
Courts of Justice Act, which became effective on January 1, 1985. The
Ontario legislature concluded that Section 10 of Canada's Currency and
Exchange Act prevented the expression of judgments in a foreign
currency. The new rules are these:

13 (1) Subject to subsections (3) and (4), where a person obtains an order to
enforce an obligation in a foreign currency, the order shall require payment of
an amount in Canadian currency sufficient to purchase the amount of the
obligation in the foreign currency at a chartered bank in Ontario at the close of
business on the first day on which the bank quotes a Canadian dollar rate for
purchase of the foreign currency before the day payment of the obligation is
received by the creditor.

(2) Where more than one payment is made under an order referred to in
subsection (1), the rate of conversion shall be the rate determined as provided in
subsection (1) for each payment.

(3) Subject to subsection (4), where, in a proceeding to enforce an obligation
in a foreign currency, the court is satisfied that conversion of the amount of the
obligation to Canadian currency as provided in subsection (1) would be
inequitable to any party, the order may require payment of an amount in
Canadian currency sufficient to purchase the amount of the obligation in the
foreign currency at a chartered bank in Ontario on such other day as the court
considers equitable in the circumstances.

(4) Where an obligation enforceable in Ontario provides for a manner of
conversion to Canadian currency of an amount in a foreign currency, the court shall give effect to the manner of conversion in the obligation.

(5) Where a writ of seizure and sale or notice of garnishment is issued under an order to enforce an obligation in a foreign currency, the day the sheriff, bailiff or clerk of the court receives money under the writ or notice shall be deemed, for the purposes of this section and any obligation referred to in subsection (4), to be the day payment is received by the creditor. ¹¹⁷

Section 1 achieves a result in Canadian currency comparable to an aspect of the Miliangos body of law by choosing the rate of exchange for the day before receipt of payment by the plaintiff. This day is even later than under English practice, according to which, if it is necessary for the court to authorize enforcement of a judgment, the appropriate rate of exchange is the rate on the day when enforcement is ordered. Section 3, however, empowers a court to choose a date other than the one specified by subsection (1) if the rate of exchange according to subsection (1) would be inequitable for a party. Subsection (3), therefore, resembles subsection (2) of §823 of the Final Tentative Draft of the Restatement of the Foreign Relations Law of the United States. Under the Ontario statute, the parties are able to prescribe the date as of which an exchange rate is to apply for translating a foreign currency into Canadian currency, a rule that resembles English practice. Under the Ontario rule, a contractual prescription will exclude both the statutory date under subsection (1) and the court's discretion to choose a date that would prevent inequity.

The Court of Justice of the European Communities considered the choice of exchange rate in P. Dumortier Frères SA and Others v. Council of the European Communities, a case decided on May 19, 1982.¹¹⁸ In an interlocutory judgment of October 4, 1979,¹¹⁹ the court ordered the European Economic Community to pay the applicants amounts equivalent to certain production refunds in respect of the period August 1, 1975 to October 19, 1977, because the refunds had been abolished without legal justification. The court also awarded interest at 6 percent from the date of judgment. The parties were to inform the court of the amount of compensation reached by agreement, and in default of agreement were to present their views to the court. The parties agreed on the compensation payable in terms of the European unit of account (EUA), but did not agree on the date as of which to determine the translation of the unit into French francs—and later into the European Currency Unit (ECU), when it replaced the EUA.
The applicants maintained that the date was the date of the court's interlocutory judgment. The Community authorities argued that the appropriate dates were the various dates of production. The applicants' leading arguments were, first, that the interlocutory judgment had awarded compensation and that compensation is governed by principles common to the laws of Member States. One of the principles was that the date on which interest begins to run is the same as the date for assessing damages. The interlocutory judgment had awarded interest from October 4, 1979 and not from the dates when the refunds should have been paid. Therefore, October 4, 1979 must be taken to be the date as of which the right to compensation was established and the amount of damages assessed. Second, the problem was similar to the translation into national currency when damage has been suffered in a foreign currency as the currency of account. Third, French francs are payable in France, and the payment must be in accordance with French case-law, under which the exchange rate prevailing on the date of judgment is applied for translating into French francs the amount of damage assessed in a foreign currency.

The Council argued that the interlocutory judgment awarded compensation equivalent to the refunds in units of account that would have been paid monthly during the period August 1, 1975 to October 19, 1977. The implication was that the translation of the units of account into French francs had to be made as of the various dates of production, so as to put the applicants into the same financial position they would have been in if the refunds had been paid. Furthermore, if the date of judgment were applied, the effect would be unfair because of the fluctuations in the value of currencies before that date. The deutsche mark had been revalued in relation to the unit of account, but the French franc had been devalued: German producers would lose, but French producers would profit in terms of their national currencies.

The Council argued also that the right to compensation existed before the judgment. The function of the judgment was only to establish precise criteria for assessment of the compensation. The rate of interest awarded by the court was compensation for the delay in payment.

The court held that the interlocutory judgment had not awarded arrears of refunds. It had awarded compensation for liability incurred by the Community because the refunds had been abolished unjustifiably. The compensation was equivalent to the amount of the refunds, but only as a basis for calculating the compensation. The award of interest from the
date of the judgment showed that the court intended to assess the damage as of that date. The court held that translation into the national currencies of all producers, wherever established, had to be made as of October 4, 1979.

The opinion of the Advocate General contains a useful summary of the laws of Member States of the Community on rates of exchange in relation to judgments. He offered this information to try to establish how damages would be awarded on the basis of principles common to the laws of the Member States, to which Article 215 of the Treaty of Rome refers. He found a fairly clear tendency in favor of the principle that damages must be determined with reference to the date of judgment. This principle was based on the logical consideration of restoring the capital impairment that the claimants had suffered (restitutio in integrum). In relation to noncontractual liability in both civil and criminal matters, the French Court of Cassation (Commercial Chamber) had decided in some cases that the rate of exchange at the date of payment, and in other cases the rate at the date of judgment, must be applied. By contrast, the Conseil d’Etat had taken the view in relation to the noncontractual liability of public authorities that compensation expressed in foreign currency must be translated into the national currency at the rate of exchange when the obligation arose, that is, when the damage was caused.

Italian courts regard an obligation to compensate for unlawful damage an "obbligazione di valore," from which it follows that a court, on its own motion, must take into account a loss of value suffered before judgment is rendered. If the loss is of a sum of money, the amount of money does not constitute the object of the obligation but is only a factor in measuring the damage.

In England, the Miliangos case and the The Despina R. hold that the rate of exchange at the date of payment applies. The laws of the Federal Republic of Germany, Belgium, and the Netherlands observe the same principle. The laws of Ireland and Denmark do not take account of variations in exchange rates after the date when damage occurs.

The Advocate General turned around the Council’s argument on discrimination:

5. The solution which seems to me preferable finds significant confirmation in the principle of equality. It suffices to observe in that respect that the argument put forward by the Council to the effect that the applicable rate should be that in force when each unpaid instalment of refunds fell due would give rise to
manifest discrimination in treatment between undertakings operating in countries with a weak currency (such as France) and those operating in countries with a strong currency, that is to say in countries in which the currency has acquired greater value in relation to other Community currencies in the time which has elapsed between the dates when the unpaid instalments of refunds fell due and the date of the judgment of this Court (the typical case is that of the currency of the Federal Republic of Germany). If compensation for the damage were paid in accordance with the view urged by the Council, undertakings in countries whose currency has been devalued would now receive less purchasing power, that is less wealth, than undertakings in countries whose currency has not been devalued (or has been devalued to a lesser extent). The French francs which the French undertakings would have received at the time of the production of the quantities...which did not enjoy aid have at present less purchasing power, whereas the marks which the German undertakings would have received then have today a greater purchasing power. The course of time has not been neutral but has significantly altered the relationship between currencies and thus the effective value of the damages awarded to the various undertakings. It seems to me essential that the compensation awarded today should assure all the undertakings the same purchasing power that the refunds would have given them if they had been paid at the proper time: only in that way can the principle of equal treatment be respected.123

The choice among currencies. To decide what is the appropriate currency in which to express a judgment may involve a choice among several foreign currencies. In an English case,124 cargo was shipped on a Belgian vessel from a port in the United States to a port in France. On arrival, part of the cargo was found to be damaged. The cargo receivers sued the owners of the vessel for breach of contract and incidental expenses. The sole question for the court was the currency in which the judgment for the plaintiff should be expressed. The plaintiff argued for U.S. dollars, the defendant for French francs. The franc had depreciated between the date of the damage and the date of the hearing of this case. The court recognized that changes in the relationship between the two currencies and turbulence in the exchange markets meant that the question of the appropriate currency was financially important and would recur.

The court drew the following principles from the Miliangos case-law:

(1) Where it is inappropriate to give judgment in sterling but there is more than one eligible currency, the choice must depend on general principles of the law of contract and on rules of private international law.

(2) General principles of contract require so far as possible restitutio in integrum, with due regard to what was in the reasonable contemplation of the parties.
CURRENCIES

(3) Where, as in this case, the law governing the contract is English law, the first step is to see whether, expressly or by implication, the contract provides an answer to the currency question.

(4) If the contract does show an agreed currency of account and payment, judgment can be given in that currency as the currency with which payments under the contract have the closest and most real connection.

(5) If the contract does not show an agreed currency of account and payment, the plaintiff should receive damages calculated in the currency in which the loss was felt or in the currency that most truly expresses his loss. This currency may or may not be the currency in which the loss first and most immediately arose. In ascertaining the currency in which the plaintiff should receive damages, the court must ask in what currency payment will as nearly as possible compensate the plaintiff in accordance with the principle of restitution, and whether the parties must be taken reasonably to have had this currency in contemplation.

(6) A decision to award damages in whatever currency a loss was borne or felt can be expressed as equivalent to finding the currency sum that most appropriately or justly reflects the recoverable loss.

The plaintiff was a French company that usually purchased the commodity constituting the cargo in the United States or Brazil, or to a small extent in France, for processing in France. The price was always fixed in U.S. dollars, and sales of the product after processing might be in dollars, or francs if the sale was made in France, or in the currency of the purchaser. If the sale was not in dollars, the proceeds were converted at once into dollars. If a forward sale was for payment in a currency other than dollars, the plaintiffs sold the currency forward and at once bought dollars for the same date. The reason for the practice was that the dominant currency in trade in the commodity was the U.S. dollar, so that all of the plaintiff's expenses and receipts were quantified in that currency in order to minimize the effects of exchange rate fluctuations. Futures were bought and sold in the Chicago Futures Market. The cargo in question was purchased for dollars.

The parties had not expressly agreed on the currency of compensation for damage. The bills of lading mentioned dollars, but the court did not give this fact great weight in choosing, between dollars and francs, the appropriate currency in which compensation should be expressed or the currency in which the parties would have expected loss to be measured.
SDRs, CURRENCIES, AND GOLD

The court concluded from all the facts that the currency was dollars.

*Other problems of choice.* Problems of the choice of foreign currency and exchange rate arise for legal purposes other than the expression of judgments. An example can be cited from the practice of the U.S. Securities and Exchange Commission. New and amended Rules and Regulations were promulgated on December 6, 1982 with respect to the currency in which the financial statements of foreign private issuers of securities offered in the United States are to be presented in registration filings with the Commission under the Securities Act of 1933. A registration statement normally must contain consolidated income statements for the five most recent years. The staff of the Commission has understood that the primary financial statements are to be presented in the currency of the domicile of the foreign private issuer and that supplemental financial statements are to be presented in U.S. dollars for the convenience of the U.S. reader.

The supplemental statements ("convenience translations") make it necessary to select the exchange rate for making the translation. The exchange rate was described by the Commission as the rate in effect at the date of the most recent balance sheet included in the filing. The same exchange rate had to be used for all periods covered by the consolidated income statement. This method was considered satisfactory while the par value system was in force, because it was thought that the same rate was likely to prevail during the full period covered by the financial statements.

The Commission’s practice came under critical examination after the par value system was no longer in force and exchange rates had become volatile. Critics discussed four possible methods for selecting the exchange rate or rates for convenience translations:

1. the single exchange rate as of the date of the most recent balance sheet, and applied in translations for the whole five years;
2. a single composite exchange rate based on the average of all exchange rates during the period of five years or during the last year of the five, and applied in translations for the whole five years;
3. five exchange rates reached by averaging all exchange rates for each of the five years, and applied in translations for the year of the averaging;
4. the exchange rate as of the date of the most recent balance sheet, and applied in translations for the last year of the five, the only year for which there would be translations.
A fifth approach considered by some critics has been the elimination of convenience translations. Normally, the Commission had encouraged use of the first of the four methods—namely, the exchange rate as of the date of the last balance sheet (or a later practicable date), applied to all five years.

On December 2, 1981 the Commission issued for public comment proposed new rules and corrections on the choice of foreign currency and of exchange rate. The Commission explained that the disappearance of par values made it necessary to take new steps to minimize the risk of misleading potential American investors. The Commission dealt first with the choice of foreign currency for convenience translations. The foreign currency should be the one that best depicts the effect of financial activities in the economic environment in which the foreign entity realizes its cash flows. Normally, that currency would be the one in which the primary books and records are maintained, in which the entity conducts most of its business, and in which the financial statements are reported in the country of the entity’s domicil.

Fluctuating and volatile exchange rates, as well as sustained high inflation, had made it likely that the use of a single exchange rate for convenience translations would distort performance data included in the primary financial statements. In recognition of these conditions, there had been deviations in a few cases from the approach listed as 1. above. Methods 3. and 4. had been used in some instances, and also a variant of 4. in which the exchange rate at the end of each year had been used in translating the data for that year.

Some private issuers had favored the use of average rates in each year (3. above) because it acted, in part, as an inflation deflator. The Commission believed that exchange rates were determined by many factors, and not only by relative rates of inflation. Adjustment for inflation should be dealt with separately from convenience translations. Furthermore, convenience translations, whatever method was used, obscured or rendered more difficult the analysis of an entity’s performance and of the trends in performance.

The Commission thought that each of the methods of translation had advantages and disadvantages, but no single method provided a comprehensive solution, and all might produce distortions in performance data for a particular period or in trends as reflected in the primary financial statements. The Commission was concerned too that American investors rely heavily on the U.S. dollar statements.
The rules as published on December 2, 1982 apply to filings by foreign private issuers registering securities under the Securities Acts of both 1933 and 1934. A foreign private issuer must state its primary financial statements only in the currency of the country in which the issuer is incorporated or organized, provided that a different currency may be used if all the following conditions are met:

(a) The different currency is the currency of the primary economic environment in which the operations of the issuer and its subsidiaries are conducted. Normally, the currency will be that of the environment in which the issuer primarily generates and expends cash. The practice of linking or indexing transactions to a particular currency does not mean that this currency is the reporting currency.

(b) There are no material exchange restrictions or controls relating to the different currency.

(c) The issuer publishes its financial statements in the different currency for all of its shareholders.

The currency in which the financial statements are prepared must be disclosed prominently on their face. Dollar-equivalent financial statements or convenience translations are not to be presented. Nevertheless, an issuer is permitted to present a translation in respect of the most recent fiscal year and of any subsequent period, using the exchange rate as of the most recent balance sheet included in the filing, provided that an exchange rate as of the most recent practicable date shall be used if it is materially different. (The solution of the exchange rate problem is a combination of the fifth approach mentioned above and a proviso in favor of the fourth method, subject to modification for material changes in the exchange rate.)

If the financial statements (1) are denominated in the currency of a country that has experienced cumulative inflationary effects exceeding a total of 100 percent over the most recent three-year period and (2) the statements have not been recast or otherwise supplemented to include information on a constant currency or current cost basis prescribed or permitted by appropriate authoritative standards, the issuer must present supplementary information to quantify the effects of changing prices on the issuer’s financial condition and results of operations.
Selected financial data must be disclosed in all filings, including:

(i) in the forepart of the document and as of the latest practicable date, the exchange rate into the U.S. dollar of the foreign currency in which the financial statements are denominated;
(ii) a history of exchange rates for the five most recent years and any subsequent interim period for which financial statements are presented, setting forth the rates for period-end, the average rates, and the range of high and low rates for each year; and
(iii) if equity securities are being registered, a five-year summary of dividends per share stated in both the currency in which the financial statements are denominated and U.S. dollars based on the exchange rates at each respective payment date.

For the purposes of this rule, the rate of exchange means the noon buying rate in New York City for cable transfers in foreign currencies as certified for customs purposes by the Federal Reserve Bank of New York. The average rate means the average of the exchange rates on the last day of each month during the year.

Other Problems of Fluctuating Exchange Rates

Fluctuating rates have produced or intensified legal problems that do not involve the choices discussed above. Some illustrations of these other problems are examined under the headings Contract law, Trust law, and Tax law.

Contract law. The legal consequences of fluctuating exchange rates become more abundant as the courts decide an increasing number of problems created by present exchange arrangements. Numerous legal problems arise because of the fluctuation of exchange rates, but fluctuation may or may not be an explicit element in the ratio decidendi of a case. Furthermore, the decisions may modify earlier legal doctrine, as in the Miliangos case, or earlier doctrine may be unaffected. If earlier doctrine is modified, the fluctuation of exchange rates is likely to be an element in the ratio decidendi.

In one English case, the problem arose because of the fluctuation of exchange rates, but it was a problem of the interpretation of a contract and not of the appropriateness of doctrine in an environment of fluctuating exchange rates. In the English case, a vessel was built in Japan for the benefit of the owner, a Liberian corporation, which operated from Greece.
The owner paid the builder 30 percent of the purchase price, and agreed with the builder that the other 70 percent should be financed on mortgage. First and second mortgages were executed, the first between the owner and the builder. The owner gave 14 promissory notes for ¥135 million each, drawn by the owner in favor of the builder, for payment of the balance. The first mortgage was assigned to a Japanese organization.

The second mortgage, which was subordinate to the first mortgage, was between the owner and the National Bank of Greece, which had guaranteed the first six of the promissory notes. The total principal sum contingently secured was ¥996 million. The stated purpose of the second mortgage was to secure repayment by the owner of all sums that the bank might be called on to pay under the guarantee. Both mortgages required the owner to insure up to 130 percent on hull and machinery. Any failure to comply with the insurance obligation under the first mortgage was a default under the second mortgage.

The policies were for the benefit of the assignee of the first mortgage, the bank, and the owner, in that order. The sums secured by the mortgages were in yen, but the mortgages provided that the vessel was to be insured in U.S. dollars for the full insurable value of the vessel and in any event for not less than 130 percent of the amount of the mortgages. At all material times, the yen was appreciating against the dollar.

The owner insured the vessel for US$10 million, which was sufficient to cover 130 percent of the amount outstanding under the first mortgage and any amounts paid under the guarantee, because these amounts would reduce what was payable under the first mortgage and enure to the benefit of the bank. The owner failed to meet the first promissory note, and the bank paid it. The failure was a default under the second mortgage, but instead of foreclosing, the bank decided to entrust management of the vessel to the Panamanian defendant, a company that operated from Greece. Under a tripartite agreement to which the defendant, the owner, and the bank were parties, the owner appointed the defendant to “act as quasi-owner.” The defendant undertook to manage in the best interests of the owner and the bank, and to insure “in accordance with the respective insurance clauses of the mortgage in favour of the bank.”

The owner’s insurance was renewed by the defendant, again in the sum of US$10 million. But by then the yen had appreciated to such an extent that about US$12 million would have been required to cover 130 percent of the outstanding liabilities under the first and second mortgages.
The vessel sank and was a total loss. The owner claimed almost US$2 million, alleging that the defendant had failed to comply with its obligation to insure the vessel for about US$12 million. As a result, the insurance was insufficient to cover the payment the plaintiff had made to the builder. The defendant contended that its obligation was fulfilled so long as the insurance complied with the second mortgage. The amount of US$10 million was sufficient for this purpose. The court rejected this argument, holding that the duty of the defendant was to protect the interests of the owner and the bank, and neither had any protection against the prior rights of the assignee of the first mortgage unless the obligations under that mortgage were satisfied. The defendant argued that it was exempted from liability under a clause in the management agreement that provided exemption for loss arising out of "any error of judgment." The court held that the defendant had not made an error of judgment, because there was nothing to suggest that the defendant had ever addressed itself to the question of the increase in the exchange value of the yen. The court noted that the appreciation of the yen against the dollar should have been foreseen. Would such a clause apply if an obligor considers possible exchange rate movements and arrives at a wrong conclusion?

Bernina Distributors, Inc. v. Bernina Sewing Machine Co.\textsuperscript{131} is an important decision of the United States Court of Appeals for the Tenth Circuit, because it is the first American decision that considered the question whether a contracting party can claim relief from a contract on the ground of impracticability on the basis of changes in exchange rates.\textsuperscript{132} The case dealt also with the question whether relief could be based on a doctrine of unconscionability because of currency depreciation. The issues, therefore, involved considerations of doctrine because of fluctuating exchange rates.

The defendant, a Utah corporation, imported sewing machines from Switzerland and supplied them to the plaintiff, a California corporation. The plaintiff paid for the machines with Swiss francs. The contract between plaintiff and defendant in issue in this case was made in 1971 and was to run for seven years and longer in some circumstances. The contract prescribed what were, in effect, fixed dollar prices for existing, replacement, and new models, although there was provision for passing on to the plaintiff increases or decreases in the Swiss manufacturers' invoice costs to the defendant, as well as provision for a surcharge of 10 percent on increased prices charged by the manufacturer on replacement models.
With the precipitous decline in the exchange rate for the U.S. dollar against the Swiss franc, the defendant began to impose a 10 percent surcharge on invoices for existing and replacement models to recompense the defendant for the increased cost of purchasing Swiss francs. The plaintiff objected to this practice and also to the defendant's method of using the current (instead of the 1971) exchange rate to calculate the price for new models. The plaintiff brought this action to get an interpretation of the contract. The trial court upheld the plaintiff's objections.

The defendant appealed. His first argument was that, although the exchange rate had fluctuated mildly before the contract was entered into, by the time of trial the decline in the exchange rate for the dollar had almost halved the defendant's rate of return per dollar invested. The defendant argued that the continuous and substantial depreciation of the dollar had not been foreseen when the contract was entered into and as prices were open under the contract, the court should establish a reasonable price in the circumstances. The court rejected this argument because the contractual provisions on basic prices and modifications in them were comprehensive. The modifications provided for passing on to the defendant increases in the manufacturer's billings to the plaintiff, plus a 10 percent surcharge on these increases for replacement machines, but these provisions did not include the defendant's increased cost of purchasing Swiss francs. The defendant had accepted the risk of a diminishing profit margin on increasing costs not included in prices chargeable to the plaintiff in accordance with the contract.

The defendant argued that the court's interpretation made the contract impracticable under Utah's enactment of the Uniform Commercial Code of the United States. The law provides that a party is excused from performance of his contract, "except so far as a seller may have assumed a greater obligation," when performance "has been made impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made...." The court refused to hold that the contract had been made "impracticable" by the contingency of the depreciation of the dollar, because the contract always allowed a margin of gross profit, even though the return on capital investment had been greatly reduced because of the depreciation. In addition, there was evidence that depreciation had been within the defendant's contemplation and that the defendant had accepted the risk. Comment 8 attached to the provision in the Uniform Commercial Code states that:

[The exemptions of this section do not apply when the contingency in question is sufficiently foreshadowed at the time of contracting to be included among the}
business risks which are fairly to be regarded as part of the dickered terms, either consciously or as a matter of reasonable, commercial interpretation from the circumstances.\textsuperscript{135}

Furthermore, Comment 4 on the provision declares that increases in cost, though great in extent, do not come within the concept of impracticability. In one case, it has been held that the doctrine of impracticability was not available unless the party invoking it could show that he could perform only at a loss and that the loss would be especially severe and unreasonable.\textsuperscript{136} That test was not met in the instant case.

Next, the defendant contended that the contract was unconscionable within the meaning of a provision in the Utah Code,\textsuperscript{137} because the defendant had been unaware of the risk of exchange rate fluctuation, because the defendant was unaware of the construction the court would put on the contract, and because the Swiss manufacturer had put pressure on the defendant to enter into a contract with the plaintiff. A Comment on the Uniform Commercial Code states that the principle of the provision is one of “prevention of oppression and unfair surprise... and not of disturbance of allocation of risks because of superior bargaining power.”\textsuperscript{138} It must be proved that the contract is “so one-sided as to be unconscionable under the circumstances existing at the time of the making of the contract.”\textsuperscript{139} The court emphasized the clause relating to the relevant time in this formulation.

The court in this case added:

This Court has previously held that an increase in price has nothing to do with unconscionability. Bradford v. Plains Cotton Cooperative Ass’n, 539 F.2d 1249, 1255 (10th Cir. 1976). Lack of oppression is particularly clear in this case because Importer is guaranteed a gross profit. Exchange rate fluctuations before the date of the contract were relatively small, and a provision limiting price increases to cost was not so one-sided as to be oppressive at the time of the contract’s making. In addition, Importer was aware of the possibility of a reduction in profits due to exchange rate fluctuations and could have guarded against this contingency. Indeed, Distributor several times suggested that a cost-plus formula be utilized, (Ex. 7) but Importer refused, insisting on a fixed profit scheme. (Ex. 8) Importer was represented by counsel throughout and should have known that the contract provided for price increases only to the extent of actual cost increases. We cannot agree that Importer was forced by the manufacturer to conclude whatever deal Distributor demanded; there is no significant imbalance in the financial strength of these parties. To grant relief on this issue would be to disturb an agreed-upon allocation of risk between commercial equals.\textsuperscript{140}
Hardship and other protective clauses have been discussed in Pamphlets No. 22, 33, and 40. On this topic, Pamphlet No. 40 examined proposals of the United States Federal Maritime Commission to establish currency adjustment factors (CAF) that would reflect changes in the exchange rates for tariff currencies by all common carriers by water and conferences of such carriers engaged in the foreign commerce of the United States. Formulas of this kind are intended to bring about the automatic adaptation of tariffs that will be reasonable and fair for carriers, conferences, and shippers. It was noted that "the construction of a formula that is satisfactory to all interests may be a difficult undertaking." On September 6, 1983, the Secretary of the Federal Maritime Commission gave notice that it was discontinuing the proceedings. The notice stated that the Commission was doing so after considering the comments on the proposal submitted by conferences, carriers, and shippers. The Commission would continue to monitor the industry's practices and shippers' complaints concerning the industry's CAFs in the foreign trades of the United States.

A commentator on the Bernina case has suggested that the case has left open the possibility that exchange rate variations may make a contract commercially impractical under legal doctrine. This possibility may exist if exchange rate changes have gone beyond the normal or predicted range and were not foreseeable. That changes beyond this range would not occur might be considered a basic assumption of the parties when the contract was made. The collapse of the par value system and resort to a floating exchange rate system was only remotely foreseeable when the contract was made. (It is not clear from the report of the case when in 1971 the contract was made. If it was entered into before August 15, 1971, it would be unreasonable to assume that the President's action on that date to abrogate the official convertibility of the dollar could have been foreseen.) The commentator makes the further point that, whatever the prospects may be for succeeding on the ground of impracticability in the future, success is unlikely if, as in the Bernina case, the contracting party trying to establish the excuse is suffering a reduction in profit but not a financial loss.

Trust law. The cases outlined above illustrate the impact that fluctuations in exchange rates can have in the law of contract. In another English case, the impact was in the law of trusts and produced a change in earlier doctrine. The instrument establishing a trust may prescribe the trustees'
powers of investment, which may be either wider or narrower than those laid down by the general law. Subject to any such prescription, statutes culminating in the Trustee Act 1961 of the United Kingdom have governed the investment powers of trustees. The 1961 statute establishes an elaborate code, but application may be made to the court for an extension of the codified powers in an individual case. The courts had held, however, that the powers conferred by the Act were to be treated as prima facie sufficient and not to be extended unless, on particular facts, a special case could be made for extending them. In recent years, courts had frequently treated circumstances as special. The Law Reform Committee's Report on The Powers and Duties of Trustees, issued in October 1982, found the Act to be "tiresome, cumbrous and expensive in operation," and commented that "the present statutory powers are out of date and ought to be revised." New statutory provisions have not yet been adopted.

In the case under discussion, the trustees of the British Museum applied to the court for an extension with respect to certain trusts of their powers of investment as established in 1960. The court explained why it thought that a new approach should be taken to such applications:

The evidence before me establishes that over the last 20 years significant changes in investment practice have occurred, especially in the case of large trust funds. The main factors producing these changes may be summarised as follows. First, increased rates of inflation have encouraged a movement from fixed interest investments to equities and property. As I have mentioned, by 1960 the purchasing power of the pound had fallen to about half of what it had been in 1939; and in the next 20 years it lost some five-sixths of that reduced value. Second, differences in rates of inflation between one country and another have from time to time made it wise to replace investments in one country by those in another. Third, the exploitation of oil and other natural resources in certain countries has markedly affected the value of particular currencies. Fourth, in recent years the rate of economic growth has been greater in some countries (not least in Japan) than in the United Kingdom. Fifth, leading companies in the United Kingdom have found it difficult to grow faster than the economy as a whole, whereas some smaller companies with specialist markets have been able to grow faster. There have also been trends away from the manufacture of capital goods towards the service and energy industries, and away from manufacturing "high volume" goods towards manufacturing which adds a high value to the goods. Sixth, the abolition of exchange controls in October 1979 has greatly facilitated overseas investment. Coupled with these factors has been an increased volatility in prices, with sharp changes taking place within three or four days, and sometimes a day. Seventh, unit trusts and
certain forms of unsecured loans such as Eurobonds now offer valuable investment opportunities.

I feel no doubt that it is in the best interests of the trustees and the trusts that there should be relaxation of the terms of the 1960 scheme which will take account of these changes. The court thought that the earlier cases in which the Trustee Act 1961 was considered a constraining influence in responses to applications should be followed no longer. Those cases were authorities rebus sic stantibus. The court should examine each application on its merits without the restraint of having to find “special circumstances.”

Tax law. It is not surprising that fluctuations in exchange rates produce effects in tax law. One expert has written: “In those far off, pre-Smithsonian days, companies did not have (or more accurately, did not realise they had)” currency problems. He noted that companies realized they had certain tax problems, and there were experts on national tax laws, but the problems of transnational taxation did not inspire much attention. Another author has warned that too much reliance should not be placed on earlier (English) case-law, because the world financial markets then were very different than those of today. For most of the period covered by the cases the world’s monetary system was tied to a fixed exchange rate unlike today when floating exchange rates prevail and there is a highly sophisticated forward exchange market.

In England, the House of Lords has taken an important decision in *Pattison v. Marine Midland Ltd.* The company, which carried on the business of international commercial banking, in October 1971 borrowed US$15 million by an issue of unsecured subordinated loan stock at par for that amount, redeemable in ten years. At the exchange rate when the borrowing was made, the sterling equivalent was £6,024,096. When the company redeemed the loan stock by repaying US$15 million, the sterling equivalent was £8,465,011. The tax authorities took the view that the sterling difference of £2,440,915 was a capital loss and not deductible in the computation of profits subject to corporation tax.

The US$15 million borrowed by the company was used to lend U.S. dollars to its banking customers. The company did not speculate in foreign exchange transactions. Its profits were the result of differences between interest paid and interest received. The loan raised by the company was repaid after five years when the customers had completed repayment of the loans made by the company. The tax authorities claimed that the...
difference of £2,440,915 between the sterling value of the loans to customers and the sterling value of their repayments was an income profit subject to corporation tax.

The House of Lords decided that the company had made neither a capital loss nor any other loss when it repaid the loan it had received and that the company did not make any income or other profit when its customers repaid the loans they had received. The company was taxable on the profit it had made as a result of the difference between the interest paid to the holders of loan stock and the interest received from customers. The principle, the House of Lords held, was that

a profit or loss may be earned or suffered if a borrower changes the currency he borrows but that profit or loss arises from the exchange transaction and not from the borrowing.133

There was no exchange profit or exchange loss because the dollar assets and liabilities were matched, there were no conversions, and a separate set of accounts was kept for the dollar assets and dollar liabilities. As changes in the exchange value of the dollar assets and dollar liabilities balanced out because of the matching, nothing was brought into the company’s profit and loss account.154

It is worth noting that the House of Lords affirmed the decision of the Court of Appeal,155 and that, in the lower court, the Master of the Rolls (Sir John Donaldson) drew an analogy between the pre-Miliangos law on the currency of judgments and the posture of the tax authorities. The position of the House of Lords was, in effect, that an English company can have only sterling assets and sterling liabilities and make sterling profits and incur sterling losses, in whatever currencies those assets, liabilities, profits, and losses are expressed. The Master of the Rolls had not been persuaded that there was any such basic concept.

Prior to 1976, the English courts adopted an attitude which is analogous to that of the revenue [tax authorities] in the instant case. Foreign currencies did indeed exist as a fact of life and they had a distressing habit of changing their exchange values, but it was their value and not that of sterling which changed. All transactions must therefore be converted into sterling and, when this was done, justice would prevail. In Miliangos v. George Frank (Textiles) Ltd. [1976] A.C. 443, the House of Lords recognised that this was far too insular a view and that treating sterling as the only true money of account was in some circumstances to work very grave injustice. And so a new rule was introduced which allowed other currencies to be used as the money of account and, where that was done, brought in sterling purely as a money of payment of last resort.156

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SDRs, Currencies, and Gold

An American case can be compared with the Marine Midland case. National Standard Company, a Michigan corporation that manufactured metal products, borrowed Luxembourg francs from a Luxembourg bank to acquire a 50 percent interest in a Luxembourg corporation. When the first payment on the loan became due, the petitioner borrowed Belgian francs (in an amount equal in dollar value to the Luxembourg francs) from a Belgian bank to refinance the loan. Later, National Standard, after selling the stock in the Luxembourg corporation, borrowed Belgian francs from a Chicago bank to pay off the loan to the Belgian bank. Each time National Standard borrowed francs to pay off a loan, the value of the francs in U.S. dollars had increased, so that National Standard was required to pay more dollars to obtain the francs than the francs were worth in dollars when the loan was received. In all instances, the borrowed currencies were used immediately on receipt by National Standard for the purposes noted here.

The question for the court was whether these losses were deductible as ordinary losses or as capital losses. The court held that the loans were negotiated to acquire a capital asset (the stock in the Luxembourg corporation), but the loan transactions had to be treated as distinct from the underlying transaction and its liquidation. The losses on the currency transactions had to be treated separately from the profit or loss on the sale of the stock, but the character of the former losses had to be determined. The court noted that:

The introduction of foreign currency into business transactions such as this has given rise to a rather limited, but sometimes inconsistent and indecisive, number of court opinions on how to characterize such transactions for tax purposes. Slight differences in circumstances seem to have been relied on by the courts to reach different conclusions with respect to somewhat similar transactions.

National Standard argued that the losses were incurred in its ordinary business operations, and should be deductible on that basis. The tax authorities argued that the losses were capital losses because the foreign currencies were capital in the hands of National Standard, and because the use of the funds to repay loans constituted sales or exchanges of capital assets, on the theory that the currencies were acquired and used directly in connection with the acquisition of capital assets (the stock). The court held that, for the losses to receive treatment as capital losses, it was
necessary to prove that the losses had arisen from (1) a sale or exchange (2) of property (3) that qualified as a capital asset.

The court held that the foreign currencies were property and must be considered capital assets because National Standard did not regularly buy and sell foreign currency in the course of its business. Nor were the currencies borrowed or purchased as a hedge against fluctuations in exchange rates. The currencies were acquired and used solely to acquire stock in the Luxembourg corporation, that is to say, as an integral part of a capital transaction. But the repayment of a borrowing with borrowed currency was not a sale or exchange of property at a loss. The loss occurred because the amount of the debt itself had increased in terms of dollars. National Standard succeeded in its contention.

The taxpayer received more favorable treatment in the English case than in the American case. In the English case, the taxpayer borrowed a foreign currency, lent it, and used repayments to the taxpayer in the same currency to repay its own borrowing. The court held that there was no exchange transaction and therefore no exchange loss. In the American case, the taxpayer borrowed to repay the loans it had received. Here, too, it was held that there was no sale or exchange of property, but the taxpayer was deemed to have suffered an ordinary business loss.

A leading Australian case can be compared with the English and American cases. Avco Financial Services carried on business as a finance company in Australia, providing its customers with consumer credit by means of personal loans, hire-purchase transactions, and consumer mortgages. To raise money for these purposes, and to repay amounts already borrowed, Avco Financial Services borrowed in Australia and the United States. Some loans were for one to five years, and others for shorter periods, which were usually extended from time to time. No borrowing was made for specific lending transactions by the company, but it borrowed no more than was necessary for lending to customers and repaying obligations in the course of general business. Borrowed moneys were not invested. The longer-term loans usually included a condition that the proceeds were to be used as they were used in the company’s ordinary business. Avco Financial Services converted U.S. dollars borrowed for its lending transactions into Australian dollars. U.S. dollars borrowed for repayment of earlier borrowings by the company remained for a day or two in a bank in the United States until used for repayment. Because of fluctuations in the exchange rate of the Australian dollar, Avco Financial
Services made exchange gains on repaying its borrowings in the United States in three years; both gains and losses in two years, resulting in a net gain in one year and a net loss in another; and then a substantial loss in one year. Over the whole period, the company suffered a net loss.

The case has similarities to the English and American cases. The taxpayer in the English and Australian cases conducted financial business, although the funds borrowed by the Australian taxpayer were converted and used exclusively in Australia, while the funds borrowed by the English taxpayer were not converted and used in international lending. The American taxpayer conducted a manufacturing business. In both the American and Australian cases the taxpayer borrowed to repay loans it had received, but in the English case the taxpayer did not borrow to repay earlier borrowing.

The question for the Australian court was whether the gains and losses were capital or revenue in character. If they were revenue according to ordinary usages and concepts, gains were assessable income and losses were allowable deductions. The tax authorities argued that exchange gains or losses on the repayment of borrowed moneys are always capital gains or losses. The High Court decided that the gains were of a revenue nature. The reasoning of members of the court contained some differences of nuance. For Chief Justice Gibbs, the *ratio decidendi* was as follows:

Where a taxpayer carries on the business of borrowing and lending money, the moneys used for that purpose are analogous to trading stock—the taxpayer in effect deals in the money. Exchange gains and losses, regularly and frequently made and incurred, in the course of making repayments of borrowed money which is used by a taxpayer in making loans in the course of its finance business are outgoings made in the day to day conduct of the business and for the purpose of carrying on the business as a going concern... [T]he additional moneys paid as a result of the unfavourable exchange variations—the exchange losses—were part of the price by which the appellant obtained the money which it used to make a profit—part of the process by which the appellant obtained regular returns. The payments were recurrent and frequent, although irregular, and they involved the exercise of judgment by the officers of the appellant who put its borrowing policy into effect as part of the conduct of the business. The exchange losses were in my opinion losses on revenue account, and of course the gains have the same character.  

The court reached the same conclusion as in the American case.

A subsequent Australian case demonstrates that the decision in the case discussed above is a limited exception to the primary principle. The exception was based on the consideration that Avco Financial Services
was a finance company and borrowed abroad for on-lending in its business. In the later case, Hunter Douglas was an Australian company engaged in the development, manufacture, and marketing of certain home improvement and building products. Hunter Douglas received a stand-by credit from a Belgian bank and a Dutch bank under which it was entitled to draw US$2 million or the equivalent in another currency chosen in consultation between Hunter Douglas and the Belgian bank. The facility was for the purpose of financing the company’s business in Australia and was available for a period of seven years, subsequently extended to ten years. Hunter Douglas drew Swiss francs and U.S. dollars, converting some part of the drawings into Dutch guilders. The company was the subsidiary of a Dutch corporation. The parent company negotiated a stand-by facility of US$4 million with an English bank. The agreement permitted a subsidiary to draw U.S. dollars or any other freely convertible Eurocurrency. Hunter Douglas drew U.S. dollars. All repayments under both agreements were to be in the currency drawn. Hunter Douglas sustained exchange losses on all repayments. The proceeds of all drawings had been used to provide funds for the day-to-day operating expenses. The Australian dollar depreciated against the currencies drawn during the periods of the loans. Hunter Douglas thus suffered a loss in terms of Australian currency as a result of repayments.

Hunter Douglas contended that the borrowed funds were used for the purpose of gaining or producing assessable income, or in the course of carrying on a business for that purpose, and therefore all the costs involved, including exchange losses, were deductible in the calculation of income. The trial court held that the exchange losses were on revenue account because of the use that the taxpayer had made of the borrowed funds. The court held that the drawings were not made as a means of financing the business of the taxpayer, but instead were used in enabling the taxpayer to earn profits. The court held that the case was within the ratio decidendi of the earlier case discussed above.

The Full Court of the Federal Court reversed this decision by a majority opinion, reasoning as follows:

1. Whether an exchange loss incurred on the repayment of an overseas loan is an outgoing on capital or revenue account depends on whether the purpose of the borrowing is characterized as capital or revenue.

2. Borrowing money to carry on a business or to pay liabilities incurred in a business is prima facie to increase the capital employed in the
business. The purpose would be to finance expansion of the business by obtaining additional working capital. The actual use a borrower makes of the proceeds of a loan are not necessarily conclusive of the character of the loan transaction. The use of the resources in day-to-day operations may free other resources for capital purposes.

(3) Only two exceptions to the second proposition have been recognized judicially: (a) exchange losses suffered in the repayment of debts incurred overseas for the purchase of trading stock are allowable deductions, and exchange gains are assessable; (b) exchange losses incurred by a taxpayer engaged in the business of lending money in repaying overseas loans used for the purpose of acquiring funds for on-lending in the taxpayer’s business are on revenue account, and exchange gains are assessable.

In this case, Hunter Douglas could not bring itself within either exception; the loans were made for special purposes on only two occasions and not as an integral part of the taxpayer’s trading operations. The exchange losses were on capital account and not deductible. Leave to appeal to the High Court has been refused.

The English, American, and Australian cases illustrate the problems that fluctuating rates produce under tax law when repayments of loans are made in foreign currencies and the taxpayer suffers exchange losses in terms of its own depreciated currency. The courts have approached these problems with diverse doctrines. Uncertainty is increased because moderate differences of fact are responsible for the diverse treatment of taxpayers under a single national tax law. These differences of fact do not necessarily reflect different economic situations from the standpoint of the taxpayer. Diverse legal treatment of similar economic consequences impels tax authorities to assert that particular situations should be classified in a way that maximizes taxes. Present exchange arrangements may not have created all these difficulties, but the fluctuations in exchange rates that the arrangements permit have intensified the difficulties.

Persistence of Former Par Values

The former par value of a currency established under the Articles before the Second Amendment, though abrogated as a result of the Second Amendment, can continue to be recognized for limited legal purposes. It will be seen later in this pamphlet that the former par value of the U.S. dollar ($42.22 per ounce of fine gold) has been applied by the Supreme Court of the United States in Trans World Airlines, Inc. v. Franklin Mint Corporation et al. for the purpose of applying the Poincaré franc in the

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Warsaw Convention. The United States continues to value its official gold holdings on the same basis. The Gold Commission of the United States recommended that the Treasury and the Board of Governors of the Federal Reserve System should study the issues involved in valuing gold at something closer to market prices. The Commission recommended that the studies should develop a formula and a timetable for the purpose. The change should not permit the proceeds of a new valuation to be monetized or to be used in any way to enhance the Government’s spending power.

It will be seen later in this pamphlet that in Borletti Brothers Inc. v. Dolphin Shipping Agency, a Genoa court supported its conclusion that a gold unit of account in another international convention had to be applied on the basis of the market price of gold with the argument that various countries were valuing their gold reserves by reference to market prices. As noted above, the United States is not following this practice. Nor is the Federal Republic of Germany. The German Institute for Economic Research (DIW) criticized the Bundesbank’s practice of valuing its gold at $42.22 per ounce of fine gold, notwithstanding the fact that the market price was a substantial multiple of the official price. The Federal Ministry of Finance issued a statement pointing out that the Bundesbank is required by both the Bundesbank Act and company law to value its holdings of gold and foreign exchange at procurement cost or market value, whichever is lower. The Ministry emphasized that any manipulation of the value of the Bundesbank’s assets designed to increase the amount of profit transferred by the Bundesbank to the Federal Government might easily be construed both in the Federal Republic of Germany and abroad as an expression of the Government’s unwillingness or inability to gain control over the country’s rising public sector debt. The Ministry pointed out that the implications in terms of monetary policy would give further grounds for concern.

Legal provisions of a different character may require the application of par values after their abrogation, although these provisions are likely to be modified as soon as possible after the effective date of the Second Amendment. Such modification is not as controversial as a change in the valuation of official gold holdings. The Court of Justice of the European Communities has had to deal with numerous cases involving Article 63 of the Staff Regulations of Officials of the Community, which until March 31, 1979 provided that:

An official’s remuneration was to be expressed in Belgian francs.
SDRs, CURRENCIES, AND GOLD

It shall be paid in the currency of the country in which the official performs his duties.

Remuneration paid in a currency other than Belgian francs shall be calculated on the basis of the par values accepted by the International Monetary Fund, and in force on 1 January 1965. 166

The Staff Regulations also provided that an official could ask to have part of his emoluments transferred to a country other than the one in which he performed his duties. Until March 31, 1979, such transfers were to be made “at the official rate of exchange in force at the date of the transfer.” 167 This rate was taken to be the parity that resulted from the latest par values accepted by the Fund of the Belgian franc and of the currency in which the transfer was made. The par value of the Belgian franc had remained unchanged since November 1, 1969.

Total remuneration expressed in Belgian francs, including the part transferred to another country, was to be weighted to reflect living conditions at the place of employment, and the weighting was adjusted also to reflect the depreciation of currencies. As a result, an official employed in a country with a currency that had depreciated below the par value could obtain special advantages by transferring part of his remuneration to a country with a strong currency. Similar anomalies arose in connection with pensions.

For the present purpose, what is of interest is that the system as outlined above was based on par values. The Council adopted amended Staff Regulations to eliminate the anomalies, but the amendments were to apply from April 1, 1979. For a year after April 1, 1978, therefore, the system was based on extinct par values. The cases were brought by applicants who objected to the amended Staff Regulations for a variety of reasons, including unequal treatment of employees and a doctrine of acquired rights. The applications failed. 168

Gold

United States: Warsaw Convention

Courts in the United States had adopted different decisions on how the limitation provisions of the Warsaw Convention for the Unification of Certain Rules Relating to International Transportation by Air, October 12, 1929 (the Warsaw Convention) are to be applied since the abrogation of the par value system. The Supreme Court of the United States decided on
April 17, 1984, by a majority of eight votes to one, in *Trans World Airlines, Inc. v. Franklin Mint Corporation et al.*, how the problem was to be resolved.\(^\text{169}\) Since 1974, the U.S. Civil Aeronautics Board (CAB) had informed international carriers doing business in the United States that the minimum limit on carriers’ liability for lost cargo would be $9.07 per pound avoirdupois. This amount was the U.S. dollar equivalent per pound avoirdupois of the number of Poincaré francs per kilogram established as the limit on liability by the Warsaw Convention, to be translated into any national currency.\(^\text{170}\) The amount in U.S. dollars was derived from the last par value of the dollar ($42.22 per ounce of fine gold) established under the Articles before the Second Amendment. The Poincaré franc is defined as the equivalent of 65\(\frac{1}{2}\) milligrams of gold nine-tenths fine.

The Federal Aviation Act of 1958\(^\text{171}\) conferred on the CAB rule-making authority that included the function of translating the Poincaré franc into U.S. dollars. Article 22(4) of the Warsaw Convention provides that “[t]hese sums [in Poincaré francs] may be converted into any national currency in round figures.”\(^\text{172}\) The CAB required international carriers by air to file tariffs declaring the limit on liability for cargo that they claimed. The CAB was able to reject any tariff that the CAB deemed to be inconsistent with the Federal Aviation Act or CAB regulations. In exercising its rule-making authority, the CAB had to act in accordance with the treaty obligations of the United States.

Trans World Airlines, Inc. (TWA) complied at all times with the CAB regulations. On March 23, 1979, Franklin Mint Corporation (Franklin) delivered 714 pounds of numismatic materials to TWA for carriage from Philadelphia to London, without any special declaration of value, but alleged in the proceedings to be worth $250,000. The packages never arrived, and TWA, when sued, acknowledged liability for the loss. The only issue that remained in the proceedings was the amount of TWA’s liability. The U.S. District Court held that TWA’s liability was limited to $6,475.98, on the basis of $9.07 per pound avoirdupois. The U.S. Court of Appeals for the Second Circuit affirmed the judgment, but it held that after 60 days from the issuance of the court’s mandate the liability limit under the Warsaw Convention would be unenforceable in the United States.\(^\text{173}\)

TWA challenged the declaration by the Second Circuit Court of Appeals on the forthcoming unenforceability of the liability limit, which was a matter of considerable concern for air carriers. TWA argued that the
last par value of the dollar was the correct solution, but the SDR solution would be an acceptable alternative. Under the SDR solution, the limit is calculated as a number of SDRs on the basis of the ratio between the definition of the Poincaré franc and the definition of the SDR in terms of gold according to the Articles before the Second Amendment. The value of the SDR in terms of the U.S. dollar on the relevant date is applied to the limit in SDRs calculated on the basis of the foregoing ratio. TWA no longer argued in favor of equivalence between the Poincaré franc and the current French franc as another possible solution. Franklin contended that the court should declare the limit unenforceable retrospectively, as well as prospectively. The Supreme Court held that the limit of $9.07 per pound was not inconsistent with the Warsaw Convention and rejected the declaration of prospective unenforceability by the Court of Appeals, from which it followed that retrospective unenforceability was equally unacceptable.

In summarizing recent monetary developments, the Supreme Court made the obviously incorrect statement that “[e]ffective April 1, 1978, the ‘Special Drawing Right’ (SDR) was to become the sole reserve asset that IMF nations would use in their mutual dealings.” This proposition could have led the court to hold that, as the SDR is the successor to gold in the international monetary system, the SDR solution should be adopted when it is necessary to apply a gold unit of account.

The Supreme Court noted that the Court of Appeals had reasoned that a conversion factor, as it is called, was necessary for enforcing the Warsaw Convention, but that no U.S. legislation had specified such a factor. The Supreme Court disposed of this reasoning by recalling the canon of construction that clear congressional action is necessary to prove a contention that Congress has intended the repeal or modification of a treaty. The text and legislative history of the Par Value Modification Acts of the United States and the repealing statute made no reference to the Warsaw Convention and provided no evidence of such an intention.

Furthermore, the court continued, the Warsaw Convention is a self-executing treaty. No domestic legislation is necessary to give the Convention the force of law in the United States, and no statute was passed. The court held that the repeal of purely domestic legislation should not be considered the implied abrogation of any part of the Convention.

In further support of its objection to unenforceability of the liability
limit, the court referred to the provision of the Warsaw Convention that requires a signatory to give to other signatories notice of an intention to withdraw from the treaty six months before withdrawal. The United States had not given notice and indeed, in its brief as amicus curiae, the Executive Branch had insisted that the liability limit was still enforceable.

Finally, in response to Franklin’s argument that a treaty ceases to be binding when a fundamental change in conditions occurs, the court responded that a treaty is in the nature of a contract between states. When the parties to a treaty assert that it is still in force, a private person who finds the treaty inconvenient may not invoke the doctrine of rebus sic stantibus.178

The court, having found that the liability limit was still enforceable, had to decide how the limit was to be expressed in U.S. dollars. The Warsaw Convention permitted each signatory to prescribe the mode of translation. The court said that Article 22(4) of the Warsaw Convention “expressly” permitted each signatory to determine the way in which the Poincaré franc is to be translated into the national currency. This statement can be questioned. The provision, as quoted above, declares that the amounts in Poincaré francs “may be converted into any national currency in round figures.” This language could be understood only to authorize rounding the amounts in national currency, particularly because of the use of the verb “may,” while the liability limits, to be effective, “must” be translated into the national currency. If this view of the provision were accepted, it would inevitably imply authorization to prescribe the mode of translation. In any event, the Federal Aviation Act required translation into dollars.

The Supreme Court disagreed with the view of the Court of Appeals that Congress, in repealing the par value legislation, had repealed the “unit of conversion” (the mode of translation) specified by the Convention without specifying another unit. The Court of Appeals had held that the substitution of a new unit of conversion was a political question, and unsuitable for judicial resolution. The Supreme Court rejected this analysis, because the Convention did not specify a unit of conversion. The CAB had taken that action. The court was not called on to substitute a new unit of conversion. The issue for the court was whether the CAB’s action was inconsistent with domestic legislation or with the Warsaw Convention—an issue that did not involve a political question.179

The Supreme Court found no inconsistency with domestic legislation. When an official price of gold was in existence because of the Par Value
Modification Act, the CAB had applied that price. When Congress repealed the statute, there was no hint that in the future the CAB should use a different conversion factor.

The Supreme Court considered that the question whether the CAB’s choice of $9.07 per pound avoirdupois was compatible with the Warsaw Convention was “more debatable.” The court held that application of the market price of gold would fail to give effect to the purposes of the Convention and would be inconsistent with international practice, as acquiesced in by the signatories, for more than fifty years. The first and most obvious purpose of the Warsaw Convention was to set some limit on a carrier’s liability for lost cargo. Any conversion factor would have this effect; a limit of $9.07 per pound was as reasonable as a limit based on SDRs or the free market price of gold. By “reasonable,” the court must be taken to have meant that a limit was a limit, no matter how it was expressed.

The Supreme Court went on to consider other purposes of the treaty:

The Convention’s second objective was to set a stable, predictable, and internationally uniform limit that would encourage the growth of a fledgling industry. To this end the Convention’s framers chose an international, not a parochial, standard, free from the control of any one country. The CAB’s choice of a $9.07 per pound liability limit is certainly a stable and predictable one on which carriers can rely. We recognize however that in the long term effectuation of the Convention’s objective of international uniformity might require periodic adjustment by the CAB of the dollar-based limit to account both for the dollar’s changing value relative to other western currencies and, if necessary, for changes in the conversion rates adopted by other Convention signatories. Since 1978, however, no substantial changes of either type have occurred.

Despite the demise of the gold standard, the $9.07 per pound liability limit retained since 1978 has represented a reasonably stable figure when converted into other western currencies. This is easily established by reference to the SDR, which is the new, non-parochial, internationally recognized standard of conversion. On March 31, 1978, for example, 1 SDR was worth $1.23667; on March 23, 1979, $1.28626. At all times since 1978 a carrier that chose to set its liability limit at 17 SDRs per kilogram as suggested by Montreal Protocol No. 4 would have arrived at a liability limit in dollars close to $9 per pound.

To support the conclusion that the CAB’s factor satisfied the purposes of stability, predictability, and international uniformity for the time being, although perhaps not indefinitely, the court gave the following reasons:

1. The CAB’s factor had represented “a reasonably stable figure when
converted into other western currencies,” as “is easily established by reference to the SDR, which is the new, non-parochial, internationally recognized standard of conversion.” 83 This reasoning is confused. The court seemed to be saying that $9.07 per pound had been equal over time to a largely unvarying number of units of each of the other “western” currencies. To demonstrate this proposition, the court cited the approximate stability of the relationship between the U.S. dollar and the SDR, apparently because the SDR is defined by reference to the market exchange rates for specified amounts of five “western” currencies. The court quoted values for the SDR on two dates, apparently because Franklin had delivered the packages to TWA on one of them (March 23, 1979), and because the court thought that the position one year earlier was revealing. The court said that, “for example,” SDR 1 was equal to $1.23667 on March 31, 1978 and $1.28626 on March 23, 1979. 84

An argument based on what is, in effect, the stability of exchange rates between the U.S. dollar and other currencies is obviously unacceptable in view of the volatility of exchange rates. The argument based on the stability of the relationship between the dollar and the SDR is equally questionable. On April 17, 1984, the day on which the court’s decision was delivered, SDR 1 was equal to $1.05813. The values of SDR 1 at the end of a few earlier months were as follows, but were not cited as “examples”:

<table>
<thead>
<tr>
<th>Dollar Value of SDR 1</th>
</tr>
</thead>
<tbody>
<tr>
<td>November 1983</td>
</tr>
<tr>
<td>December 1983</td>
</tr>
<tr>
<td>January 1984</td>
</tr>
<tr>
<td>February 1984</td>
</tr>
<tr>
<td>March 1984</td>
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</tbody>
</table>

The liability limit of SDR 17 per kilogram would have resulted, on the basis of the value of the SDR in terms of the dollar on April 17, 1984 ($1.05813), in a conversion factor of approximately $8.15 per pound avoirdupois. Statistics for later dates would show even more striking instability. For example, the dollar value of the SDR at the end of the following months was as follows:

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
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</thead>
<tbody>
<tr>
<td>September 1984</td>
<td>$0.9990</td>
</tr>
<tr>
<td>December 1984</td>
<td>$0.9802</td>
</tr>
</tbody>
</table>
There is a strong suggestion in the court’s opinion that the U.S. dollar is a stable currency. If there is instability in exchange rates, the explanation may be that other currencies are fluctuating in value. The assumption that sterling was a stable currency was a reason for the pre-Miliangos insistence that judgments could be expressed only in sterling, and the same reason may explain why the practice of American courts continues to be that judgments can be expressed only in dollars, notwithstanding the modified approach of the proposed revision of the American Law Institute’s *Restatement of the Foreign Relations Law of the United States*. The institutions of the country that issues what is commonly regarded as the central currency under prevailing monetary arrangements may be tempted to assume that its currency is more stable than other currencies.

As suggested above, the court may have chosen to cite the value of the SDR in terms of the U.S. dollar on March 31, 1978 and on March 23, 1979 because the earlier date was the last day before the Second Amendment became effective, while the later date was the day on which the cargo was delivered to TWA. The failure to give values for subsequent dates, however, cannot be explained on the ground that the dates cited were the only dates the court considered relevant, because the court said “we cannot fault the CAB’s decision to adhere, in the six years since 1978, to a constant $9.07-per-pound liability limit.”

185 2. The court found that $9.07 per pound “appears to have been a reasonable interim choice for keeping” the liability limit “in line with limits enforced by other signatories.” 186 The reasoning seems to have been that a conversion factor based on the last par value for the U.S. dollar gave results close to the results that were being achieved by other signatories to the Warsaw Convention. The court could not have meant that the techniques for translation chosen by signatories were reasonably similar to each other. The court noted that, by December 31, 1975, 15 nations had signed Montreal Protocol No. 4, which showed their intention to accept a liability limit of SDR 17 per kilogram. Some nations were applying the last official price of gold for translating the liability limit into the national currency. A footnote to the court’s decision recognized that some signatories were applying the SDR solution. 187 The court placed much
reliance on the use by other signatories of the SDR as the standard for translating the Poincaré franc, while itself refusing to enforce the SDR solution by way of interpretation of the Convention.

The court returned in the following passage to consideration of the market price of gold:

We recognize that this inquiry into the dollar’s value relative to other currencies would have been unnecessary if the CAB had chosen to adopt the market price of gold for converting the Convention’s liability limits into dollars. Since gold is freely traded on an international market its price always provides a unique and internationally uniform conversion rate. But reliance on the gold market would entirely fail to provide a stable unit of conversion on which carriers could rely. To pick one extreme example, between January and April 1980 gold ranged from about $490 to $850 per ounce. Far from providing predictability and stability, tying the Convention to the gold market would force every carrier and every air transport user to become a speculator in gold, exposed to the sudden and unpredictable swings in the price of that commodity. The CAB has correctly recognized that this is not at all what the Convention’s framers had in mind. The 1978 decision by many of the Convention’s signatories to exit from the gold market cannot sensibly be construed as a decision to compel every air carrier and air transport user to enter it.¹⁸⁸

What the court meant by the decision of countries in 1978 “to exit from the gold market” is unclear. The reference is to the Second Amendment, which became effective on April 1, 1978, and which frees members of the Fund from the earlier legal constraints on them under the Articles with respect to the prices at which they could engage in transactions in the market. The members decided not to leave the market but to deal in it more freely if they chose, whether the market was between central banks or what used to be called the free, private, or nonofficial market. Members have an implied obligation under the Second Amendment not to maintain a fixed price for gold transactions, as well as an express obligation not to maintain the external value of their currencies by reference to gold. Notwithstanding the imprecision of the court’s dictum, the objection to the market price in applying a liability limit under the Warsaw Convention should be beyond controversy. The dissenting judge, however, held that the majority was not enforcing a liability limit in the Convention, but rather the limit set by TWA and accepted by the CAB on the ground that it was more compatible with the purposes of the Convention. In preferring the market price of gold, he considered absolute uniformity the main
purpose of the Convention and not the approximation to uniformity that the majority struggled to discover in justification of its solution.\textsuperscript{189}

The Supreme Court suggested that another intended purpose of a gold unit of account “may have been to link the Convention to a constant value, that would keep step with the average value of cargo carried and so remain equitable for carriers and transport users alike.”\textsuperscript{190} The court recognized that a fixed dollar-based limit on liability in the long run might not achieve this purpose in inflationary conditions. This objection was dismissed with the response, first, that the drafters of the Warsaw Convention thought that it would be in force for only a few years, and, second, that the parties to the Convention had tolerated without change the substantial increase in the market price of gold (and of other commodities) when compared with the official price of gold in the more prolonged period in which the Convention had remained in force. The volatile market price of gold as a commodity did not reflect inflation and would serve no purpose of the Convention.

The Supreme Court held that, “[a]s of March 31, 1978, $9.07 per pound of cargo therefore represented a ‘correct’ conversion of the Convention’s liability limit into dollars.”\textsuperscript{191} The date of March 23, 1979, instead of March 31, 1978, might have been closer to the true ratio decidendi of the decision. The sentence quoted referred only to March 31, 1978, without any mention of the six years after 1978, notwithstanding the court’s earlier reference to that period.

The decision accepts the last official price of gold in U.S. dollars as the standard for translating the Poincaré franc into the national currency of the United States, but the court did not insist that this technique must prevail in all circumstances before Montreal Protocol No. 4 becomes effective. The solution had achieved the purposes of the Warsaw Convention to a reasonable degree and was at least a “reasonable interim choice.” This conclusion rested on a challengeable assumption about the stability of the dollar.

The court declared that the solution it was endorsing had achieved results that were reasonably uniform with those that would be obtained by application of the SDR solution, but this reasoning also is open to challenge. Even if a liberal view were taken of what constituted uniform results, uniformity was not inherent in the solution. Diversity might be increased as divergence increased between the results of applying the last official price of gold and the results of the SDR solution, and as a growing
number of countries turned to the SDR solution. The court noted in a footnote\textsuperscript{192} that Canada, Italy, South Africa, Sweden, and the United Kingdom had already adopted the SDR solution by legislation. It is likely that even more countries have taken this step. The Federal Republic of Germany and the Netherlands are certainly among them.\textsuperscript{193} The court’s emphasis on the actions taken by signatories other than the United States to apply the SDR solution in determining the liability limits of the Warsaw Convention could be understood to imply that, in the court’s view, sooner or later the SDR solution would be more effective in achieving the purposes of the Convention. It is undeniable that the SDR is the only choice for a unit of account to replace a gold unit and that the SDR is, therefore, the only unit of account that can achieve uniform results. If the results achieved by applying the last official price of gold in terms of the dollar are regarded as comparable—and it is submitted that they are not—this comparability would be fortuitous.

The court obviously recoiled from applying the SDR solution by interpretation because of the objection, accepted by the Court of Appeals, that this solution would substitute a new unit for the unit in the Warsaw Convention. Nevertheless, the court did not rule that the last official price of gold was the ineluctable solution. It had been applied by the administrative decision of the CAB, and it had worked well enough as an interim measure. The court might find that a different administrative decision would satisfy the court if different circumstances were proved, and it is submitted that they could be proved. The U.S. Department of Transportation, to which the surviving functions of the CAB were transferred as of January 1, 1985, could find that, in the circumstances that have developed (including the variability in the exchange rate of the U.S. dollar), tariffs are to be filed on the basis of SDR 17 per kilogram of gold, expressed in the dollar equivalent per pound avoirdupois.

**France: Warsaw Convention**

It will be recalled from the discussion of *Trans World Airlines, Inc. v. Franklin Mint Corporation et al.* that TWA abandoned the argument that, if its main contentions on translating the Poincaré franc into U.S. dollars failed, liability should be limited on the principle that, in present circumstances, the current French franc must be deemed to be the successor to the Poincaré franc. TWA’s contention with respect to the French franc had been inspired by the decisions of the Court of Appeal of
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Paris in Société Egyptair v. Chamie \(^{194}\) and the Court of Appeal of Aix-en-Provence in Pakistan International Airlines v. Compagnie Air Inter S.A. et al. \(^{195}\) Those courts rejected the solutions based on the SDR and on the market price of gold in favor of the current French franc as the unit of account.

The Court of Cassation (Commercial Chamber) on March 7, 1983 quashed the decision of the Paris court in Société Egyptair v. Chami, \(^{196}\) which probably explains why TWA abandoned the contention that had been based on the French franc. The Court of Cassation remitted the case to the Paris Court of Appeal with what amounted to the following instruction:

Whereas, by imposing upon the parties a method of computation different from the one provided for by the Warsaw Convention, and whereas trial judges must abide by the official interpretation given by the governmental authority to which they must apply if the provisions of a diplomatic treaty submitted to them for interpretation involve monetary public policy as defined by international agreements in force, the Court of Appeal violated the provision of the Warsaw Convention. (Translation)\(^{197}\)

No French court has applied the SDR solution. This dictum of the Court of Cassation has a strong resemblance to the decision of the United States Supreme Court. The unit of account in the Warsaw Convention cannot be supplanted by judicial interpretation, but the courts must defer to the official interpretation by the appropriate governmental authority on how the unit of account in treaties must be applied. The court expressed this principle in relation to all diplomatic treaties involving monetary public policy.

Italy: Brussels Convention on Bills of Lading

Borletti Brothers, Inc. v. Dolphin Shipping Agency, \(^{198}\) decided in Genoa on March 11, 1981, involved the application of the gold unit of account in the International Convention for the Unification of Certain Rules of Law Relating to Bills of Lading, done at Brussels on August 25, 1924 (the Brussels Convention). \(^{199}\) Italy is a contracting party to the treaty. The pertinent part of Article 4, paragraph 5 provides that

5. Neither the carrier nor the ship shall in any event be or become liable for any loss or damage to or in connection with goods in an amount exceeding 100 pounds sterling per package or unit or the equivalent of that sum in other currency unless the nature and value of such goods have been declared by the shipper before shipment and inserted in the bill of lading. \(^{200}\)
According to Article 9,

The monetary units mentioned in this convention are to be taken to be gold value.

Those contracting states in which the pound sterling is not a monetary unit reserve to themselves the right of translating the sums indicated in this convention in terms of pound sterling into terms of their own monetary system in round figures.

The national laws may reserve to the debtor the right of discharging his debt in national currency according to the rate of exchange prevailing on the day of the arrival of the ship at the port of discharge of the goods concerned.

Goods dispatched to the plaintiff had been loaded in Milwaukee, Wisconsin, on board a Canadian vessel on July 28, 1976, but they could not be found when the vessel reached Genoa. The plaintiff brought an action in Italy against the agency that represented the shipowner there. On the issue of the amount of the judgment, the plaintiff argued that the limit on liability under the Brussels Convention had to be computed on the basis of the gold content of sterling at the date of the Convention in 1924 (7.32 grams) and the market price of gold at the time of judgment (about 18,000 lire per gram). The result of this computation was about 26 million lire (7.32 x 18,000 x 100 x 2). The defendant offered to pay compensation in the amount of 990 Netherlands guilders, representing it to be the limit under the Brussels Convention. The value of the lost goods was equal to 18,736.99 guilders, or slightly more than 8 million lire at the exchange rate at the time of the decision (then fluctuating around 435 lire per guilder). There was some connection of the case with the Netherlands that was relied on to justify the reference to the Netherlands guilder by the defendant and by the court, but the connection does not appear in the report.

The defendant argued that the value of the gold unit in the Brussels Convention was to be determined by the gold content of sterling in 1976 and the current price of gold in the official market. The defendant based the argument in favor of 1976 on the fact that the contractual obligation for the dispatch of the goods had been entered into at that time, and that the Brussels Convention, in contrast to the many conventions in which the Poincaré franc was the unit of account, did not define the gold value of sterling. The absence of a definition suggested that the negotiators of the Brussels Convention had not intended to adopt the gold value of sterling in 1924.
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The Genoa court rejected the argument in favor of 1976, because the legislative history of the Brussels Convention showed clearly that the gold value of sterling in 1924 was the intended standard. Another reason the court gave for this choice was that the Brussels Protocol of February 23, 1968 was evidence of intention, even though it was not yet effective. The Protocol in Article 2(a) amended Article 4, paragraph 5 of the 1924 Convention by adding the words "in an amount exceeding" "the equivalent of Frs. 10,000 per package or unit or Frs. 30 per kilo of gross weight of the goods lost or damaged, whichever is the higher," with the franc defined as the equivalent of the Poincaré franc. This reasoning is an interesting example of the legal consequences that are sometimes attributed to a treaty that has not taken effect (and is unlikely ever to take effect). The reasoning is also an example of the use of subsequent conduct as evidence in the interpretation of a treaty, in this case a treaty more than 40 years old. Finally, the court rejected the gold value of sterling in 1976, because acceptance of the argument in favor of it would imply that the British monetary authorities were entitled to modify the unit of account in the Brussels Convention unilaterally by changing the gold value of sterling. The court did not mention that sterling was a floating currency, so that determination of its gold value in 1976 was itself a problem.

The defendant argued that the second determinant, the value of gold, had to be the official price of gold in U.S. dollars that had been established in accordance with the Fund's Articles, namely $42.22 per ounce. The defendant stated that the Articles had never been abrogated. This statement was true, because the Articles have remained in force continuously since December 27, 1945, but this case was decided in 1981, well after the fundamental change in the role of gold under the Second Amendment, which became effective on April 1, 1978.

The court held that the former official price of gold could not serve as the current standard because the price had been based on the convertibility of U.S. dollars into gold and on a monetary system with the dollar at its center. These conditions had not existed since 1971, although the official gold market had not been formally abolished. What was meant by the "official gold market" was unclear. If it meant transactions in gold between members, there were no longer restraints on the prices that members may observe in these transactions, provided that members do not seek to maintain a fixed price for gold. Furthermore, the court continued, to apply the former par value of a currency would result in unequal...
recoveries, because currencies were floating. The market price of gold was more realistic and was preferable as a standard, because it involved fewer elements of uncertainty; only the price of gold fluctuated while currencies in general were floating. The court continued as follows:

Secondly, it must be noted that, while it is true that the official gold market has not been formally abolished, it is also true that a decision was made to maintain it only in the framework of relations between states and solely for the purpose of avoiding excessively strong destabilizing movements. Furthermore, the gold reserves of various countries are constantly valued on the basis of the current free market price of gold. (Translation)\textsuperscript{203}

The decision by states mentioned in the first sentence of this passage is probably the decision on the two-tier gold system, but this system was terminated in November 1973.\textsuperscript{204} Not all countries value gold in their reserves on the basis of the current free market price. The United States, for example, is a country that does not. The phrase “on the basis of” is suitably vague, because of the diverse techniques that prevail among states in valuing their official holdings of gold.\textsuperscript{205}

The court then moved on to consider the SDR solution, which it rejected:

Finally, with regard to the view that the value of gold should be determined by recourse to the SDR, it is true that some conventions replace a sum expressed in gold with sums expressed in units of account, defined as baskets of fixed amounts of national currencies; reference is made in particular to the special drawing right of the International Monetary Fund. The Brussels Convention—the only one applicable in the case in hand—does not refer to such units of account, however. Nevertheless, the use of units of account is not problem-free, either. For one thing, they take account of the major currencies’ trends only; for another, they too are subject to fluctuation, since they consist of national currencies. (Translation)\textsuperscript{206}

The court advanced three objections to the SDR in this passage: (1) no mention of the SDR in the Brussels Convention, (2) the composition of the SDR as a basket of fluctuating currencies, and (3) the fluctuating value of the SDR. No comparison was made between the degree of fluctuation in the value of the SDR and the market price of gold.

The court decided that the market price of gold was the correct standard, notwithstanding fluctuation of the price. The court had to choose the date as of which to apply the price. The plaintiff argued that the date of judgment should be selected. The court rejected this contention because the purpose of Article 4, paragraph 5 of the Brussels Convention is to
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enable the carrier to know in advance the risk he runs in accepting a shipment. For the limit on liability to be waived, the value of the goods must be declared and included in the bill of lading, so that the carrier can increase the freight charges if he wishes. These considerations induced the court to hold that the appropriate price is the one that prevailed when the contract for transportation was signed. In this case, the bill of lading did not indicate the value of the lost cargo, so that the limit of liability under the Brussels Convention applied.

The court's conclusions led to this computation of the limit on liability:

\[ 7.32 \times 5,000 \times 100 \times 2 = 7,320,000 \text{ lire} \]

The actual loss was 18,736.99 Netherlands guilders, equivalent to 6,058,793 lire at the exchange rate of 323.36 lire per guilder on the same date. The plaintiff was entitled to the full amount of the loss because it was less than the limit on liability.

This finding was not sufficient to dispose of the case. The amount calculated had to be adjusted to take account of the inflation that had occurred since the loss of the goods. The reassessment raised a novel question. Was the reassessed amount subject to the limit imposed by the Brussels Convention? The court pointed out that Article 4, paragraph 5 referred to "any loss or damage to or in connection with goods," and that, as provided by Article 1(e), the loss or damage must be incurred during shipment. The court deduced that the liability limit did not apply to loss or damage of any other origin, such as a decline in the purchasing power of money. The amount owed to the plaintiff (6,058,793 lire) had to be recalculated in accordance with changes in the indices of consumer prices for workers and employees from September 1976 (the date of nonperformance) to the date of settlement, with legal interest on the basis of the revalued amount from September 1976.

Italy: Warsaw Convention

In Saint Paul Fire and Marine Insurance Co. v. S.E.A., the Milan court, in a decision of November 19, 1979, had followed similar reasoning in concluding that the Poincaré franc in the Warsaw Convention had to be applied on the basis of the market price of gold. The court took a view on what was meant by the market price:

The result of establishing a new system based on "central rates" (definable since November 1973 without even an indirect reference to gold) has been the reciprocal fluctuation of the various currencies, which continues today. The outcome is that the official value of gold has lost any practical meaning.
As a result it seems to be altogether unrealistic to convert the amount in question using the official gold value of the dollar, even if some foreign decisions prior to 1973 were handed down using this criterion.

It is thus necessary . . . to take as a reference the current price of gold on the major European and U.S. markets (Zurich, London, New York). Contrary to one authoritative view, this price cannot be fairly reduced as the purpose of such a reduction would be to impede, nullify, or in any case, substantially decrease the effectiveness of the clause limiting the carrier’s liability as set forth in the Convention. (Translation) 218

The Netherlands: CMR

The Convention on the Contract for the International Carriage of Goods by Road of May 19, 1956, for which CMR is the acronym in common use, derived from the French title, is one of a number of conventions on unimodal transit concluded under the auspices of the United Nations Economic Commission for Europe (ECE). Under these conventions, the liability of carriers is limited in terms of the Germinal franc, which is defined as 10/31 gram of gold nine-tenths fine. Agreement was reached on July 5, 1978 on Protocols to the CMR and the other conventions of the same group, under which the SDR would be substituted for the Germinal franc as the unit of account when the Protocols took effect. The substitution would be based on the ratio between the definition of the SDR in terms of gold before the Second Amendment and the definition of the Germinal franc. 211

In Frigoscania Transport B.V. v. Sea Products International, 212 the Hague Court of Appeals on November 12, 1982 confirmed the decision of the lower Rotterdam court on the application of the Germinal franc. Goods were carried from Marseilles via the Netherlands to an English destination, where the goods, on arrival, were found to be damaged. The carrier paid the owners of the goods 10,767.94 pounds sterling, which, according to the carrier, was the value in sterling to which its liability was limited in terms of the Germinal franc under Article 23(3) of the CMR (25 Germinal francs per kilogram). 213 The owners claimed the difference between the amount received in sterling and the limit (58,951.08 Germinal francs) under the CMR translated into Netherlands currency.

The appellate court stated that sweeping changes had occurred in international payments since the CMR had been negotiated and that, as a result, gold had lost all monetary significance. It followed that “the suitability of the franc expressed in gold as a general unit of account for
setting internationally uniform liability limits has been lost.\textsuperscript{214} A gap existed in the CMR that had to be filled. The decision that liability limits expressed in terms of a gold unit of account cannot be enforced resembles the finding of the Second Circuit Court of Appeals in \textit{Trans World Airlines, Inc. v. Franklin Mint Corporation et al.} The Protocol of July 5, 1978 to the CMR, which would have solved the problem, had not yet taken effect for the Netherlands, but a law of May 15, 1981 of the Netherlands had taken effect on March 15, 1982 and had been made applicable to the CMR by Royal Decree of January 19, 1982. Under the statute and the decree, the gold franc referred to in Article 23(3) of the CMR is deemed to be equivalent to one third of an SDR. Furthermore, Article 2(2) of the Protocol provides that the SDR is to be converted into the currency of the forum on the basis of the value of the SDR at the date of judgment.\textsuperscript{215}

The court held that the provisions of English law expressing the limit on liability in sterling, on which the carrier had relied, depart from both the original CMR rules, under which the Germinal franc is the unit of account, and the rules based on the SDR. The English legal provisions were exclusively national in character and did not apply to proceedings in the Netherlands. The limits expressed in SDRs under Netherlands law had to be applied and translated into guilders at the value of the currency on the date of judgment.

A strange feature of the case is that, before the Rotterdam court and The Hague Court of Appeals delivered their decisions in 1982, the Protocol of July 5, 1978 to the CMR had taken effect for the United Kingdom, although the Protocol had not yet taken effect for the Netherlands. The United Kingdom was bound from December 28, 1980, on which date a statutory order\textsuperscript{216} brought into force provisions of the Carriage by Air and Road Act of 1979.\textsuperscript{217} The statute substituted the SDR for the Germinal franc on the basis of the SDR solution.\textsuperscript{218} The United Kingdom, by means of these provisions, was giving effect to a change in the law that followed from the Protocol, but the Netherlands, acting on its national initiative, was filling a gap in the CMR by analogy to the Protocol even though the Protocol was not yet binding on the Netherlands. The Netherlands legislature had found a solution for continuing to enforce the limits in the CMR, while in the \textit{Franklin Mint} case the Supreme Court found the solution.

The sterling payment was made before the United Kingdom gave the force of law to the Protocol. The damage to the cargo was discovered

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when the vessel arrived on July 14, 1980, and the payment was made on October 30, 1980. The carrier insisted that this amount was in accordance with the limitation of its liability expressed in Germinal francs under the CMR, but the Netherlands court held that the plaintiff had not agreed and had not accepted the amount in full settlement. The Netherlands proceedings were instituted on December 11, 1981.

The report of the case provides no explanation in support of the conclusion that English law could not be reconciled with the CMR or the Protocol. The practice of the United Kingdom under some conventions, and under the statutes giving them the force of law, that contained a gold unit of account has been to issue statutory orders after the official price for gold was abrogated. The statutory orders have prescribed the sterling value of the unit by translating it into the SDR according to the SDR solution. The sterling equivalent remains in force until a new statutory order is issued. Perhaps a statutory order of this kind had been issued in respect of the Germinal franc in the CMR, although no such statutory order has been discovered. (The payment may have been calculated by analogy to the official prescriptions of value made by statutory orders issued in respect of other conventions.)

If, however, there was such a statutory order in respect of the CMR, the Netherlands court might have objected to a sterling equivalent fixed as of an earlier date than the date of payment in sterling, because the value of the SDR might have been different when the payment was made. Perhaps, in addition, the reference to the incompatibility of English law with the CMR meant that the value of the Germinal franc based on the market price of gold was also a fluctuating value.

The court cited a provision of the Protocol to support the view that the translation into Netherlands currency had to be made as of the date of judgment, even though the Netherlands had not yet accepted the Protocol. The court held that this principle did not conflict with the provisions of Netherlands law.

It is not clear why the plaintiff was dissatisfied with the amount received in sterling, but it can be assumed that a judgment in guilders at the rate of exchange prevailing at the date of judgment would have been more advantageous for the plaintiff.

Austria: Warsaw Convention

In Kislinger v. Austrian Airtransport, the Commercial Court of Vienna, sitting as the Court of Appeals, decided on June 21, 1983 how it would
apply the Poincaré franc in the Warsaw Convention. The plaintiff, on a flight from Madrid to Vienna on April 20, 1981, lost photographic equipment, weighing 3 kilograms and purchased for 13,360.40 Austrian schillings (S.), from a valise weighing 10 kilograms. The defendant airline paid the plaintiff compensation of S. 4,100, apparently on the assumption that the claim was for the loss of the valise and its contents, but the plaintiff claimed S. 6,588 as the difference between the current value of the equipment and the compensation received, plus interest. The defendant had paid compensation of S. 410 per kilogram on the basis of the market price of gold and the limit on liability in Poincaré francs under the Warsaw Convention (250 Poincaré francs per kilogram). The lower court, applying what it considered relevant provisions of domestic law, arrived at S. 240 per kilogram, and decided that the plaintiff failed in her claim because she had been overcompensated.

On appeal by the plaintiff, the Court of Appeals held that the legal provisions on which the lower court had relied were no longer relevant, because they had been abrogated. The Court of Appeals cited Transarctic Shipping Corporation, Inc., Monrovia, Liberia v. Krögerwerft Company, decided by the Oberlandesgericht of Hamburg on July 2, 1974, which is discussed in detail in Pamphlet No. 19. That case involved the application of the Poincaré franc as the unit of account in the Treaty Concerning the Limitation of Liability of Owners of Seagoing Vessels, done at Brussels, October 10, 1957.

The Hamburg court refused to apply either the market price of gold or the latest par value of the deutsche mark established under the Articles, even though the Commercial Code of the Federal Republic of Germany declared that the Poincaré franc was to be applied on the basis of the “parity” of the currency. The par value was still in existence legally under the Fund’s Articles at the time of the decision, because the par value system had not yet been abrogated. On June 23, 1974, the Federal Republic of Germany had notified the Fund of a central rate for its currency in terms of the SDR under a decision of the Fund that had not conferred on central rates legal consistency with the Articles. The Hamburg court decided to apply the Poincaré franc by reference to the central rate and not the par value.

The Court of Appeals of Vienna held, however, that the rationale of the Hamburg case had ceased to exist on March 31, 1978 because the Second Amendment took effect the next day and because the SDR ceased to be defined in terms of gold. The court held that, in accordance with the
Austrian General Civil Code, the court was bound to find a solution by an interpretation based on language or analogy that respected the objectives of the limitation of liability in the Warsaw Convention. The objectives were uniformity in recoveries and as much independence as possible from accidental variations in currency systems. "In theory, it [the external value of a currency] should remain nominally constant until the member states decide on a change in the nominal sum, over longer periods of time, because they intend to introduce a greater liability or because the real value has changed quite decisively." It is interesting that the court adverted to, and rejected, the ratio decidendi of the Second Circuit Court of Appeals in the Franklin Mint case, which was rejected by the Supreme Court of the United States as well:

... It is therefore appropriate to seek a way that corresponds to the extent possible to the liability limitation system standardized in the WA [Warsaw Agreement], the basic tendency of which has been stated above, if one does not wish to assume the point of view that a spurious gap has arisen in the law due to the dropping of the gold parity and the maximum liability limits have become completely inapplicable.

The U.S. Supreme Court found that there was no gap in the treaty with which it was dealing and that the court could apply the Poincaré franc, in effect on the basis of American law, which authorized the CAB to choose the method of translation. The Hague court found that there was now a gap in the treaty, but that Netherlands law had filled the gap. The Vienna court rejected the analysis of a gap in the treaty, applying the unit of account by analogy to a German statute, which was not part of Austrian law, and an Austrian statute, which did not apply to the treaty in question. Both The Hague court and the Vienna court applied the SDR solution; the U.S. Supreme Court found that the last par value of the dollar was sufficiently close to the SDR solution applied by other countries.

The Court of Appeals of Vienna chose the SDR solution and supported it by referring to the similar solution adopted by the Federal Republic of Germany in its Gold Franc Conversion Law of June 13, 1980. In addition, the court referred to Austria's own Gold Franc Conversion Law, which applied to two treaties on transit negotiated under the auspices of the ECE but not to the Warsaw Convention. There may be domestic reasons why a member adopts legislation for some treaties containing a gold unit of account rather than for all such treaties. The reasons may be
unrelated to the merits of the SDR as a unit of account. The problem is less acute if, as in Austria, the domestic law expressly authorizes interpretation by analogy.

The court held that it would apply the rate of the Austrian schilling in terms of the SDR that prevailed on the date the lower court delivered its decision. The Court of Appeals, acting under the Civil Procedural Code, obtained the rate from the National Bank. On the basis of that rate, liability under the Warsaw Convention was limited to S. 308 per kilogram. The court held also that the plaintiff had lost only 3 kilograms of property. She had been entitled to no more than S. 308 x 3, but had received S. 4,100, and therefore was not entitled to more.

The Linz District Court, sitting as the Court of Appeals, is another tribunal that, on June 17, 1983, in *Rendezvous-Boutique-Parfumerie Friedrich und Albine Breitinger Gesellschaft mbH v. Austrian Airlines*, applied the SDR solution to the Poincaré franc in the Warsaw Convention.\(^{230}\) The defendant airline had paid the plaintiff S. 11,355.72 as compensation for the loss of goods, but the plaintiff claimed a further S. 5,433. The lower court awarded this further amount, basing its judgment on the market price of gold and, therefore, calculating the limit of liability under the Convention at S. 53,638.33. The judgment was overruled on appeal by the defendant, on the ground that the plaintiff had already been overcompensated.

The Court of Appeals reviewed aspects of successive versions of the Articles and the history of Austria’s exchange arrangements under the Articles. On the basis of these reviews, the court came summarily to the conclusion that the SDR solution had to be applied. The court seems to have attached some importance to the fact that Austria is a participant in the Special Drawing Rights Department, has received SDRs, holds them as reserves, and considers them to be part of the currency cover. The court seems also to have drawn some support from various provisions of the Articles that refer to the SDR as a denominator for currencies\(^ {231}\) or to the former value of the SDR in terms of gold.\(^ {232}\) The Linz court, like the Vienna court, cited Austria’s Gold Franc Conversion Law, although the law did not apply to the Warsaw Convention. The defendant’s maximum liability based on the SDR solution was S. 4,285. The Linz court held that the plaintiff was able to recover from the defendant the costs incurred by the plaintiff in the proceedings of the lower court and on appeal. These costs amounted to S. 13,639.49 and exceeded the S. 11,355.72 the plaintiff had received.
Legislation on Gold Units of Account

In the discussion of the Austrian cases, the question was raised why some countries have adopted legislation to apply the SDR solution to a gold unit of account in some existing treaties in which there is such a unit, but not in all such treaties. It was suggested that there might be special reasons of domestic interest why the general approach is not taken.

The United States has not adopted legislation of the kind mentioned above for any of the treaties to which it is a party, but American experience with respect to the Warsaw Convention illustrates the difficulties that might arise in relation to particular treaties. The caveat must be noted that the difficulties have arisen in connection with the proposed Protocols to amend the Warsaw Convention, and not in connection with proposed legislation on how the Poincaré franc must be applied in the present Warsaw Convention and in amendments already in force.

The Executive Report of the Committee on Foreign Relations of the U.S. Senate, dated February 10, 1983, reported favorably on ratification of Montreal Aviation Protocols 3 and 4, subject to three provisos to Protocol 3, which deals with limited liability for death or injury: (1) establishment of a satisfactory plan for supplemental compensation for U.S. citizens; (2) denunciation, if such a plan does not continue to be satisfactory in light of new economic or other relevant circumstances or if the best interests of U.S. airline passengers are not otherwise served by continued adherence to the Protocols; and (3) continued active negotiation by the U.S. Government of higher limits on liability.

A letter from a representative of the U.S. Administration supported ratification and on the SDR stated, in a discussion of Protocol 4, that

... by replacing gold with the far more stable Special Drawing Rights (SDR’s) as the monetary unit for quantifying treaty liability for loss, damage or delay of cargo shipments, Protocol No. 4 will reestablish fixed liability levels worldwide and avoid uncertainties surrounding awards in various jurisdictions. This feature of the Convention, revising the “gold clause,” which has been seriously eroded in several countries since the wild fluctuations in the value of gold began in the mid-70’s, is essential to the prudent calculation of insurance needs by airlines and shippers alike.

The letter was written in the period after the Second Circuit Court of Appeals had delivered its judgment in Trans World Airlines, Inc. v. Franklin Mint Corporation et al. and before the decision of the U.S. Supreme Court.
Protocol 3 has had the support of the American Bar Association, but it has been opposed by the American Trial Lawyers Association. Opposition has been directed toward the scheme in Protocol 3 of liability without fault, but subject to a limit, on the ground that the limit is unfair to victims. It is feared that this scheme would eliminate large awards of damages for clients, in which lawyers participate in receiving their contingent fees.\textsuperscript{235} On March 8, 1985, the U.S. Senate, voting by 50 to 42 in favor of the Protocols, failed to reach the two-thirds majority necessary for consent.\textsuperscript{236}

\textbf{U.S. Congress and Gold}

The U.S. Gold Commission was appointed by the Secretary of the Treasury on June 22, 1981, in accordance with Section 10 of Public Law 96-389.\textsuperscript{237} The statute was adopted to permit the United States to consent to the increase in its quota in the Fund that was proposed as a result of the Seventh General Review of Quotas, and for other purposes. Section 10(a) prescribed the composition of the Commission, and Section 10(b) declared that its terms of reference were to “conduct a study to assess and make recommendations with regard to the policy of the U.S. Government concerning the role of gold in domestic and international monetary systems.”\textsuperscript{238} The Commission sent its report to Congress in March 1982. The report is discussed in Pamphlet No. 40.\textsuperscript{239}

The report did not deter Congress from returning to the subject of gold in Public Law 98-181 of November 30, 1983,\textsuperscript{240} which authorized the United States to consent to the increase in its quota in the Fund proposed as a result of the Eighth General Review of Quotas and an increase in the credit commitment of the United States under the Fund’s General Arrangements to Borrow. The statute contained numerous requirements and instructions to the U.S. Administration that were necessary in order to ensure passage of the statute through Congress. Section 50 of Public Law 98-181 contains the following provisions:

\begin{itemize}
  \item [(c)] Not later than one year after the date of the enactment of this section, the Secretary of the Treasury shall transmit a report to the Congress with respect to strengthening the role and improving the operation of the International Monetary Fund, including—
\end{itemize}
Gold

(2) a review and analysis of—

(C) the feasibility of returning all or part of the Fund’s gold reserves to Fund members or of selling the Fund’s gold reserves in the private markets in an effort to raise capital;

(E) the feasibility of establishing a Gold Lending Facility whereby the Fund would lend gold to Fund members who would in turn use such gold as collateral for commercial loans;

(G) the effect on (i) the market price of gold, (ii) countries whose central banks maintain reserves in the form of gold and (iii) credit markets of the United States as a result of taking any of the actions described in subparagraphs (C), (D), or (E) of this paragraph;...241

On March 15, 1985, the U.S. Treasury issued a Report to Congress on the Functioning of the International Monetary and Financial System and the Role and Operation of the International Monetary Fund. The Introduction and Summary of the report contains the following paragraph:

The review concludes that the IMF’s liquidity position is currently strong enough to meet foreseeable demands for financing. The various proposals for using the IMF’s gold stock as an alternative to a future quota increase pose serious practical difficulties and could have adverse consequences on U.S. economic and financial interests. 242

The discussion in the report of the proposals to mobilize the Fund’s gold notes that the proposals were advanced as an alternative to increases in quotas: “an understandable temptation at a time of budget constraints and domestic economic difficulties.”243 Under the heading “Impact on IMF,” gold is said to be the Fund’s “basic reserve, available to satisfy creditors’ claims on the Fund in the event of liquidation and to replenish the IMF’s currency holdings.”244 Sales of gold mobilize an existing asset and do not expand the Fund’s resources. Sale of all the Fund’s holdings of
103 million ounces of gold at the current price would yield much less than the total increases in quotas and in the General Arrangements to Borrow. The gold markets are thin and volatile. The Fund would not be able to sell all its holdings over the period of a few years without depressing market prices to a major extent and perhaps drastically. Sales over an extended period would yield only small amounts for use by the Fund.

The "restitution" of gold to members at the former official price would deplete the Fund's resources. Restitution would neither strengthen the Fund's ability to deal with current problems nor help to solve the problems of members in greatest difficulty. The effect of total restitution would be that members would receive gold worth about $31 billion at market prices current at the time of the report, at a cost of $4 billion. The 110 non-oil developing members would receive about one fourth of the total gold. Even the largest debtors—Mexico, Brazil, and Argentina—would receive only about $500 million at the then current market prices. Members would receive less benefit from restitution than they would receive from quota increases and access to the Fund's resources under its normal policies: "In essence, it [restitution] is a 'get rich quick' scheme for the wealthier countries." The U.S. Gold Commission also had rejected restitution.

All the Fund's assets, including its gold, serve as backing for creditors' claims on the Fund, which arise from the Fund's net use of members' subscriptions and members' outstanding loans to the Fund. These claims at the time of the report amounted to approximately $40 billion, which was substantially greater than the value of the Fund's gold at the then current market prices.

If creditor members sought to encash their claims, which were liquid reserve assets that could be used automatically on short notice to meet balance of payments needs of these members, and if the Fund's available holdings of economically usable currency were inadequate, the Fund could mobilize its gold. Furthermore, in the event of liquidation, the creditors would have first claim on the gold if other resources were inadequate. It was unlikely that current creditors of the Fund would be willing to have the ultimate security for their claims eliminated as the result of the Fund's sales of gold, or subordinated to the rights of others to whom gold was pledged by the Fund to secure loans to it, or pledged by members to whom the Fund lent gold so that they could borrow against it in the market. Any of these actions might induce unfavorable responses by
Gold creditors, some of whom might encash their claims on the Fund. Furthermore, loans of the Fund’s gold to members, so that they could use it as security for borrowing in the market, might suggest some uncertainty about the efficacy of programs supported by the Fund and lead to a loss of confidence on the part of the markets and therefore reduce lending.

Sales or pledges of the Fund’s gold to secure borrowing would not be seen by creditors of the Fund or by weaker members to be in their interest as an alternative to increases in quotas. It was highly unlikely that decisions to take these actions concerning gold, which require a majority of 85 percent of the total voting power, could be negotiated. Loans of gold by the Fund to members are not mentioned in so many words in the Articles. The report does not discuss the legal feasibility of such operations.

Under the heading “U.S. Economic and Financial Interests,” the report considers the potential effect of the increases in the quota of the United States on the Treasury’s cash position and borrowing requirements and on domestic money and capital markets. The report concludes that the effects are likely to be minor. Yet, it is the effects of the minor increase in annual U.S. Treasury borrowing arising from the increase in quota that the proponents of sales of gold by the Fund have sought to avoid. The economic and financial effects on the United States of these sales, however, could far outweigh any costs associated with these borrowings.

Three considerations are listed as relevant to this comparison. First, the United States is one of the largest creditors of the Fund. Sale of the gold and use of the proceeds by the Fund would remove the ultimate security for the claims of the United States. Second, major gold sales could lead to a dramatic drop in price and reduce the potential value of the gold stocks of the United States and other countries holding gold reserves. The probable decline in the price of gold as the result of large sales by the Fund would have serious adverse effects on domestic gold producers. Third, the sale of gold would not eliminate the financial market effects that were thought by some to be associated with an increase in quota and with potential Treasury borrowing. Gold sold by the Fund would be acquired primarily for investment purposes, and transactions in the gold market would be largely in terms of dollars. Purchasers of the Fund’s gold would pay for it with proceeds of the sale of dollar securities, such as corporate or U.S. Treasury securities. The transactions would tend to put upward pressure on interest rates and have an impact on financial markets similar
to, and possibly greater than, the effect of borrowing by the United States as a result of the increase in quota.

**Gold Clauses and Joint Resolutions of the U.S. Congress**

The floating of the U.S. dollar and other currencies after August 15, 1971 led to various changes in the law of the United States relating to gold, in accordance with the policy of the United States to reduce the role of gold in the international monetary system, which later was incorporated in the Second Amendment as an objective. In September 1973, the U.S. Congress enacted Public Law 93–110, an Act to amend the Par Value Modification Act and for other purposes, under which the right of citizens to purchase, hold, sell, or otherwise deal in gold was restored. The provisions that carried out this purpose were to take effect when the President found and reported to Congress that international monetary reform had advanced to the point at which elimination of the regulations restricting the private ownership of gold would not adversely affect the international monetary position of the United States. In August 1974, Congress enacted Public Law 93–373 for the same purpose, but with the change that the provisions relating to gold were to take effect on December 31, 1974 or at such earlier date as the President made the finding and report referred to in the earlier statute. The substantive provision in the 1973 statute was as follows:

No provision of any law in effect on the date of enactment of this Act, and no rule, regulation, or order under authority of any such law, may be construed to prohibit any person from purchasing, holding, selling, or otherwise dealing with gold.

This provision was repealed by the 1974 statute and replaced by the following provision:

No provision of any law in effect on the date of enactment of this Act, and no rule, regulation, or order in effect on the date subsections (a) and (b) become effective may be construed to prohibit any person from purchasing, holding, selling, or otherwise dealing with gold in the United States or abroad.

The provision became effective on December 31, 1974.

Congress repealed the Joint Resolution of June 5, 1933 by Public Law 95–147, which was approved on October 28, 1977. The Joint Resolution had invalidated gold clauses in contracts. The repealing provision declared that:

The joint resolution entitled "Joint resolution to assure uniform value to the
coins and currencies of the United States,” approved June 5, 1933 (31 U.S.C. 463), shall not apply to obligations issued on or after the date of enactment of this section.

In Gold Bondholders Protective Council, Inc. v. United States, the U.S. Court of Claims was called upon to decide the effect of the legislation referred to above on a claim by the plaintiff as owner of a $50 Gold Liberty Bond of 1933–38, which was issued on October 24, 1918. The bond provided that the United States would pay the principal and interest in gold coin “of the present standard of value” on presentation by the bearer to the Treasurer of the United States on or after October 15, 1938. On April 2, 1981, the bond in issue was presented to the U.S. Treasury Department with a letter requesting that the bond be returned unless payment was made in gold coin or in U.S. currency having a face value sufficient to purchase gold coin equivalent to the value of the gold coin promised in the bond. The Treasury Department returned the bond with the statement that the submission could not be treated as a presentation and surrender of the bond for payment, because of the conditions the plaintiff had imposed. The plaintiff filed suit to recover the sum of $1,253.02 on the bond because gold was selling in the market at approximately $518 an ounce on the date when the bond was presented for payment.

The Joint Resolution declared that gold clauses were against public policy; that the use of gold clauses was prohibited thereafter; and that every obligation, whether already incurred or incurred in the future, was to be discharged upon payment dollar for dollar in any coin or currency that at the time of payment was legal tender for public or private debts. In Perry v. United States, decided by the Supreme Court, the plaintiff owned a $10,000 Fourth Liberty Loan 4¼ Percent Gold Bond, which was payable in U.S. gold coin of “the present standard of value.” The plaintiff presented the bond for payment and demanded delivery of the quantity of gold represented by $10,000 in gold coin when the bond was issued or $16,931.25 in legal tender. The Supreme Court held that the U.S. Government’s promise to pay the paper money equivalent of the gold coin specified could not be repudiated or impaired by the Joint Resolution. The decision was based on constitutional considerations. The plaintiff could not recover for breach of contract, however, because he had suffered only nominal damages and the Court of Claims, in which the plaintiff had initiated the proceedings, had no authority to entertain a claim for nominal damages.
damages. This result was based on congressional enactments of 1933 and 1934, under which private persons were required to sell to the Government all gold they held and under which the holder of gold coin could not export it or engage in foreign exchange transactions.

Congress reacted promptly to the decision that the Government could not repudiate or impair its obligation on the gold clause. Congress adopted the Joint Resolution of August 27, 1935, under which any consent that the United States had given to be sued upon any gold-clause securities of the United States was withdrawn, unless a claim did not exceed the nominal amount in dollars of the security. This Joint Resolution was still in force. The court held that it applied to the plaintiff’s bond, so that the plaintiff’s claim was barred by sovereign immunity.

The plaintiff attempted, without success, to argue that the Joint Resolution of August 27, 1935 was contrary to the Constitution and that, therefore, under the broad ruling of the *Perry* case he was entitled to succeed. The power of the United States to withdraw its consent to being sued was recognized even in the *Perry* case.

Finally, the plaintiff relied on the statutes of 1933 and 1934 giving citizens the right to hold gold. The court said that it was not clear whether the plaintiff had argued that the Joint Resolution of August 27, 1935 was no longer applicable because of those statutes. To resolve any doubt, the court stated that the statutes had not had this effect. There was no express repeal of the Joint Resolution, and there was no implied repeal. A number of cases between private parties on gold clauses had reached the conclusion that the statutes had not repealed the Joint Resolution of June 5, 1933. The rationale of these cases was equally applicable to the Joint Resolution of August 27, 1935.

**Gold Certificates and Taxation**

Section 14(c) of the Gold Reserve Act of the United States authorizes the Secretary of the Treasury to issue gold certificates against any gold held by the Treasurer of the United States. The amount of certificates issued and outstanding must not exceed the value, on the basis of the legal standard, of the gold held against the certificates. Federal Reserve banks receive the certificates in return for cash. When the United States amended the Bretton Woods Agreements Act in order to enable the United States to accept the Second Amendment of the Fund’s Articles, it repealed Section 2 of the Par Value Modification Act from the effective date of
Résumé

In *Birkenstock v. Commissioner of Internal Revenue*, the taxpayers appealed to the U.S. Court of Appeals for the Seventh Circuit from a decision of the Tax Court. The taxpayers had been held liable for a deficiency in income tax. They continued to argue that they were entitled to calculate the tax on their taxable income on the basis of the value of the "real," "statutory," or "standard" dollar. Their calculation was based on the average of the daily prices of gold fixed in London during 1974. The taxpayers relied on the Par Value Modification Act, which had established the par value for the dollar at $42.22 per ounce of fine gold. They translated their taxable income into what they called "statutory" dollars by multiplying the taxable income by $42.22 over $159.45, the average London price.

The court held that the taxpayers were mistaken in their understanding of the statutory law. The former par value of the dollar had been retained only for the purpose of issuing gold certificates, and there was no indication that this standard was meant to reflect the actual value of the dollar. Federal Reserve notes were legal tender for all debts, but gold was not legal tender. The market price of gold was irrelevant in the determination of tax.

**Résumé**

**SDRs**

1. The basket of currencies that determines the value of the SDR has been revised, with effect as of January 1, 1986, in accordance with the decision on quinquennial revisions. The currencies in the newly revised basket remain unchanged, but the weights of the four currencies other than the U.S. dollar have been modified, as have the amounts of the units of all five currencies.

2. The guidelines for rounding the number of units of currency in the basket have been amended, without prejudice to the principle of adherence to the weights and the principle that the value of the SDR in terms of currencies must be the same on the first business day after the...
revision becomes effective as the value on the last business day before the revision takes effect.

3. The revised basket applies also for the purpose of calculating the interest rate on holdings of SDRs. In short, the baskets for valuation and interest remain unified.

4. The interest rate on holdings of SDRs is established more frequently than in the past. The lag between the reference period for establishing the interest rate and the period to which the interest rate relates has been reduced. The excess of interest over charges and of charges over interest is settled more frequently by credits and debits to SDR accounts than in the past. The broad objective of the changes has been to follow more closely market practices with respect to other reserve assets—and therefore to increase the attractiveness of the SDR as a reserve asset.

5. “Other holders” of SDRs have increased to 16. One such holder went out of existence and was succeeded by a new institution that took over all assets and liabilities of the predecessor. The successor could not become a holder, or entitled to the SDRs of the predecessor, without a decision of the Fund. The decision was taken almost eight months after the succession, but the decision provided that the successor had succeeded to the predecessor’s holdings of SDRs as of the date of succession. A feature of the case is that there was no existing holder of the SDRs in the interval.

6. Criticism of the name “special drawing rights,” which was a compromise in the negotiation of the SDR system, is responsible for a rule that “SOR” shall be standard usage in the Fund, without prejudice to the authentic text of the Articles when it must be quoted. The logical implication of the rule is that any other name could be treated in the same way, but it would not have the familiarity of the acronym “SDR.”

7. The long list of treaties and proposed amendments of existing treaties or proposed new treaties in which the SDR is the unit of account or has some other function continues to grow. If nonmembers of the Fund may apply a gold franc under some treaties, the gold franc must be related to the SDR. Under these treaties, the SDR is the only unit of account. Even if a treaty is not amended to replace a gold unit of account with the SDR, the experience of the Universal Postal Union shows that it may still be possible to give the SDR that role for practical purposes.

8. The SDR basket can be adopted for some purpose even when the SDR is not a unit of account. The OECD Arrangement on Guidelines for
Officially Supported Export Credits is an example in the use made of the SDR basket for establishing matrix interest rates. The Arrangement also shows that the SDR can serve as a neutral denominator in the sense that it avoids specification of a currency and exact amounts of it.

**Currencies**

9. New decisions on surveillance over the exchange rate policies of members under Article IV, and the improvement of procedures for conducting that surveillance, are discussed.

10. An experimental procedure has been introduced for notifying the Executive Board of large changes, as defined, in real effective exchange rates (that is, large changes in competitiveness in exchange rates, whatever a member’s exchange arrangement may be).

11. The topic of “objective indicators” has arisen again. The staff of the Fund has been urged to adopt an experimental approach in studying the concept and exploring it with interested authorities.

12. A procedure of “enhanced surveillance” has been developed, by which the Fund can monitor a member’s economic policies more frequently than under ordinary surveillance procedures when a member is no longer using the Fund’s resources and the member has entered into a multiyear rescheduling arrangement with commercial banks to which it is indebted. The procedure is designed to facilitate a member’s transition to normal access to commercial financing.

13. Surveillance has been a subject discussed in a number of international reports on the international monetary system that seek ways to complement the Fund’s efforts to improve the effectiveness of the practice. The report of the Deputies of the Group of Ten, the statement by the Ministers and Governors of the Group issued on June 21, 1985, and the report of the Group of Twenty-Four are among such reports. The Fund’s Interim Committee has requested the Executive Board to study the issues raised by these reports, in order to facilitate the Committee’s further consideration of them.

14. The Fund must adopt specific principles for the guidance of all members with respect to their exchange rate policies. The three principles adopted by the Fund so far deal in part with intervention in the exchange markets. Intervention has been a topic in the Statement on International Monetary Undertakings issued after the Versailles Summit. As a result of that meeting, a Working Group on Exchange Market Intervention was
established, which has issued a report. The Finance Ministers and Central Bank Governors of the Summit Group and representatives of the European Community then made an announcement on the subject. The Finance Ministers and Central Bank Governors of the Group of Five made an announcement on September 22, 1985.

15. The understandings set forth in various of these reports and announcements, sometimes expressed in the language of agreements, raise questions of "soft law," including the meaning and role of the concept in public international law. Much attention is being paid to soft law in the current reconsideration of the sources of public international law. The prevalence of soft law is particularly noticeable in the economic relations of states.

16. The Executive Board has again left open for further consideration the question whether a special exchange rate confined to capital transactions is a multiple currency practice for which the approval of the Fund is required under Article VIII, Section 3. The issue involves the relationship of that provision and Article VI, Section 3.

17. The fluctuation of exchange rates produces new legal problems or intensifies problems that had arisen while the par value system was in force. The disappearance of that system has made it more desirable to consider, in various branches of the law, what is the appropriate currency in which to express amounts in a foreign currency, and, if that currency must be translated into another currency, what is the appropriate date as of which to choose the rate of exchange for the translation.

18. The field of judicial judgments is an outstanding one in which these two problems of selection arise. On the first problem, national systems of law fall into two groups, holding either that judgments can be expressed only in the domestic currency or that they can be expressed in an appropriate foreign currency. On the second question, national systems of law hold that the rate of exchange is the rate when a claim arises or when judgment is given (or the claim settled). Two detailed reports on these and related problems have been issued by official law revision commissions in England and British Columbia. The unofficial but influential American Law Institute has been drafting proposals on these problems for the revision of the Foreign Relations Law of the United States.

19. Problems of the choice of foreign currency and of exchange rate when exchange rates fluctuate arise for legal purposes other than the expression of judgments. The United States Securities and Exchange
Résumé

Commission has promulgated new and amended Rules and Regulations on the currency in which the financial statements of foreign private issuers of securities offered in the United States are to be presented in filings with the Commission, as well as on "convenience translations" when a foreign currency is translated into dollars. The topic illustrates also the difficulties of choice when exchange rates over a prolonged period are involved.

20. In the field of contract law, fluctuating exchange rates may provoke problems of the interpretation of contracts or of the appropriateness of established legal doctrine. The application of doctrines of impracticability and unconscionability in conditions of fluctuating exchange rates has been raised under the Uniform Commercial Code of the United States. These doctrines raise in turn the question of hardship and protective clauses.

21. Legal doctrine has been modified in relation to the powers of investment of trustees under English trust law because of the fluctuation of exchange rates.

22. Fluctuating exchange rates have produced much litigation involving their effects in tax law. English, American, and Australian cases on borrowing and repayment in a currency foreign to the borrower are examined. The courts have approached these issues with diverse doctrines. Moderate differences of fact are responsible for the diverse treatment of taxpayers under a single system of law. The differences of fact do not necessarily correspond to different economic situations from the taxpayer's standpoint.

23. Former par values continue to persist for some legal purposes. Valuation of the official gold holdings of some countries is an example. The U.S. Supreme Court's decision on the application of the Warsaw Convention is another example.

Gold

24. Much litigation has been instituted on the application of gold units of account in treaties that have not yet been amended to substitute the SDR as the unit of account when official action has not been taken by national authorities on how the gold unit in the treaty under consideration is to be applied. There is a strong, but not invariable, resistance on the part of courts to application of the market price of gold.

25. The varied approaches by courts that reject the market price of gold illustrate the difficulties of reaching uniform judicial solutions under multilateral treaties. The U.S. Supreme Court has found that, notewi-
standing the disappearance of an official price for gold, there was no gap in the treaty with which the court was dealing and the court could apply the gold unit, in effect on the basis of American law, because a regulatory agency was authorized by law to choose the method of translation. A Netherlands court has found that there was now a gap in the treaty, but that Netherlands law had filled the gap. An Austrian court has rejected the analysis of a gap and has applied the unit of account by analogy to a German statute, which was not part of Austrian law, and an Austrian statute, which did not apply to the treaty in question.

26. The statute that authorized the United States to consent to an increase in its quota in the Fund as a result of the Eighth General Review of Quotas and an increase in the credit commitment of the United States under the General Arrangements to Borrow also required reports by the Treasury on restitution to members of the Fund’s remaining gold holdings, sale of the gold in the private markets, and the feasibility of lending gold to members to enable them to use it as collateral for commercial loans. The Treasury has issued a report reacting negatively to these ideas.

27. A U.S. court has decided that current statutory law does not entitle a bondholder to sue the U.S. Government for the gold value, as determined by the gold market, of a bond containing a gold clause issued in 1918.

28. In another case, a court has decided that taxpayers were not entitled under current statutory law to reduce their taxable income by invoking the market price of gold as an indicator of the alleged statutory value of the dollar.
APPENDICES

Appendix A. SDRs: Interest and Charges

RULE T-1 OF RULES AND REGULATIONS, BEFORE AMENDMENT EFFECTIVE ON AUGUST 1, 1983

T—Interest, Charges, and Assessments in Respect of Special Drawing Rights

T-1. (a) Interest and charges in respect of special drawing rights shall accrue daily at the rate referred to in (b) below and shall be paid promptly as of the end of each financial year of the Fund. The accounts of participants shall be credited with the excess of interest due over charges or debited with the excess of charges over the interest due. The accounts of holders that are not participants shall be credited with the interest due.

(b) The rate of interest on holdings of special drawing rights for each calendar quarter shall be equal to the combined market interest rate as determined in (c) below.

(c) The combined market interest rate shall be the sum of the average yield or rate on each of the respective instruments listed below for the fifteen business days preceding the last two business days of the last month before the calendar quarter for which interest is to be calculated, with each yield or rate multiplied by the number of units of the corresponding currency listed in Rule 0-1 and the value in terms of the special drawing right of a unit of that currency as determined by the Fund under Rule 0-2(a) and (b), provided that the combined market interest rate shall be rounded to the two nearest decimal places. The yields and rates for this calculation are:

- Market yields for three-month U.S. Treasury bills
- Three-month interbank deposits rate in Germany
- Three-month interbank money rate against private paper in France
- Discount rate on two-month (private) bills in Japan
- Market yields for three-month U.K. Treasury bills
(d) The Fund will review the rate of interest on holdings of special drawing rights at the conclusion of each financial year.


RULE T-1 OF RULES AND REGULATIONS, AFTER AMENDMENT EFFECTIVE ON AUGUST 1, 1983

T—Interest, Charges, and Assessments in Respect of SDRs

T-1. (a) Interest and charges in respect of SDRs shall accrue daily at the rate referred to in (b) below. The amount that has accrued during each quarter of the financial year of the Fund shall be paid promptly as of the beginning of the following quarter. The accounts of participants shall be credited with the excess of interest due over charges or debited with the excess of charges over the interest due. The accounts of holders that are not participants shall be credited with the interest due.

(b) The rate of interest on holdings of SDRs for each weekly period commencing each Monday shall be equal to the combined market interest rate as determined by the Fund at the beginning of the period in the manner described in (c) below.

(c) The combined market interest rate shall be the sum, rounded to the two nearest decimal places, of the products that result from multiplying each yield or rate listed below, expressed as an equivalent annual bond yield, for the preceding Friday by the value in terms of the SDR on that Friday of the amount of the corresponding currency specified in Rule O-1, as determined pursuant to Rule O-2(b). If a yield or rate is not available for a particular Friday, the calculation shall be made on the basis of the latest available yield or rate.

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<th>Currency</th>
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<td>U.S. dollar</td>
<td>Market yield for three-month U.S.</td>
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<td>Treasury bills</td>
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<td>Deutsche mark</td>
<td>Three-month interbank deposit rate</td>
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<td>French franc</td>
<td>Three-month interbank money rate</td>
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<td>against private paper in France</td>
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<td>Japanese yen</td>
<td>Discount rate on two-month (private)</td>
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<td>bills in Japan</td>
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<td>Pound sterling</td>
<td>Market yield for three-month U.K.</td>
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<td>Treasury bills</td>
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Appendix B

(d) The Fund will review the rate of interest on holdings of SDRs at the conclusion of each financial year.


Appendix B. Surveillance Under Article IV, Section 3(b)

Surveillance over Exchange Rate Policies [1983]

The Executive Board has reviewed the general implementation of the Fund’s surveillance over members’ exchange rate policies, as required by paragraph VI of Procedures for Surveillance attached to Decision No. 5392-(77/63), adopted April 29, 1977, including the procedures for the conduct of consultations under Article IV, which consultations shall comprehend the consultations under Article VIII and Article XIV, and approves the continuation of the procedures as described in SM/83/43, in the light of the Managing Director’s summing up, until the next annual review, which shall be conducted not later than April 1, 1984.

Decision No. 7374-(83/55)
March 28, 1983

Attachment to Decision No. 7374-(83/55)
Managing Director’s Summing Up

GENERAL REMARKS

Directors considered that Article IV consultation reports should continue to deal with exchange rate questions in a forthright fashion while taking into account the sensitivities involved; several Directors felt that more attention should be paid to exchange rate issues outside the regular consultation process.

A number of Directors observed that Fund surveillance was not sufficiently symmetrical. They noted that precise prescriptions regarding exchange rate movements or changes are often given to small countries or countries making use of Fund resources; at the same time, quite large discrepancies between exchange rates and fundamental underlying conditions draw little attention from the Fund staff when they relate to major currencies, despite the fact that those currencies play a greater role in the working of the international monetary and financial system. In this context, several Directors stressed the importance of more frequent and more analytical Board discussions on exchange rate developments generally, and on the interrelationship and implication of policies and prospects in the major currency countries in particular. A number of Directors also called for a discussion in the Executive Board on the recent EMS realignment.

Important questions regarding the setting of financial policies and the relationship of exchange rates to underlying economic and financial conditions
SORs, CURRENCIES, AND GOLD

remain to be answered. Also to be considered is the need to develop a medium-term framework for the assessment of balance of payments developments. Directors welcomed the work in progress in the Fund in these areas, including the forthcoming paper on "Issues in the Assessment of Exchange Rates of the Industrial Countries in the Context of their Economic Policies." Such studies are expected to provide useful background for the biennial review of the principles of surveillance, which is to take place by April 1, 1984.

Many Directors emphasized the need for the Fund clearly to address the dangers associated with the growth of protectionism, and they encouraged the staff to expand the coverage and analysis of trade policy matters in Article IV consultation reports, while avoiding overlap into the areas of responsibility of other institutions, particularly the GATT. In this regard, they said, the focus should be on the impact of trade measures on domestic adjustment and the exchange rate of the relevant country and on its trading partners.

It was noted that, during 1982, debt service difficulties had become a focal point for concern. Most Directors considered it to be extremely important for the staff to do its utmost to improve the coverage of external debt developments—particularly their short-term aspects—and policies related to external debt in Article IV consultation reports. More specific proposals on that matter would be discussed in the Board meeting on external debt issues, scheduled for April 6. Some Directors also indicated that the Fund should be in a position to provide better coverage of the "liability" side of the banking sectors in member countries and their reserve management policies.

FREQUENCY OF ARTICLE IV CONSULTATIONS

Directors agreed that the consultation process is at the heart of surveillance and that, in view of the problems experienced by members in 1982 and the speed with which these problems have spread, a very determined effort needs to be made to ensure more regular scheduling of Article IV consultations. There have been cases, Directors noted, where members have run into serious external and internal imbalances during periods in which the Executive Board has not had an opportunity to analyze the issues and to offer the member the benefit of its advice. Directors indicated that such cases were unfortunate and should not be repeated in the future.

There was general agreement among Directors that some procedural changes would help to guarantee a stricter approach to the scheduling of consultations. Most agreed that the approach of establishing, at the conclusion of each consultation, a final date for the discussion of the next consultation with the member would be helpful, although specification of the cycle in this fashion should not be so rigid as to detract from management's prerogative, in consultation with the member country and the Executive Director concerned, to change the scheduling. To the extent that stricter scheduling was desirable, however, it could be enhanced by periodic reports to the Board on the status of members with respect to the observation of the consultation schedule and with an indication of any problems that might have been encountered in adhering to it. In
that regard, there was no intention to lay blame on the country concerned; the purpose of the report would be to inform the Board of the causes for the delay, such as insufficient staff, a problem in local political conditions, and so on.

The criteria for determining the countries under a strict cycle were agreed, that is, economies having a substantial impact on other countries, members with Fund-supported programs, and situations where there are substantial doubts about medium-term viability. For the large majority of members for which a stricter cycle should apply, most Directors considered that the objective should be to limit the interval between consultations to no more than 12 months, with a grace period of, say, three months beyond the specified date. For members not on a strict cycle, the permissible outer limit would be two years. Management was encouraged to experiment with six-month reviews or miniconsultations—as had been done recently in some cases—where the economic situation of the member was changing rapidly.

In considering the circumstances that might justify delays in consultations, Directors noted that military hostilities, for example, would warrant a delay; however, it was to be understood that, once the special circumstances had passed, the consultation should be held quickly. Delays for political reasons, such as elections, or delays because the member was engaged in a process of reformulating its economic policies were less clear-cut. Most Directors judged that consultations should not be delayed because of the political timetable in member countries; indeed, they observed that it was precisely in such periods of uncertainty that financial problems could emerge or become more acute. Moreover, as pointed out in the staff paper, consultations would be particularly useful and timely when a member was in the process of developing new policies. Delays should, where possible, be fitted into the grace period of three months; if that meant that the policies envisaged by the authorities could not be fully specified in the staff report, however, it might be appropriate to hold follow-up discussions at an early date, when the policies had been formulated.

Directors agreed that a number of adaptations to existing procedures might be necessary to maintain the higher average frequency of consultations that was implied by adherence to strict annual consultation cycles for most members, at least in current circumstances. Given the large number of requests for use of Fund resources expected in the coming year, it was accepted that consultation missions might sometimes be combined with negotiations of the use of Fund resources. However, a number of Directors considered that, where an annual consultation was due, its discussion in the Board should precede the Board discussion of a program. Some believed that combining consultations with requests for use of Fund resources should be the exception rather than the rule, but a number of Directors considered that consultations could appropriately be combined with reviews of existing Fund programs.

Directors stressed the importance of REDs [reports on Recent Economic Developments], which they considered to be a valuable and often unique source of economic and financial information on member countries. Directors agreed that, if necessary for logistical reasons, REDs might be shortened on a selective basis and
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perhaps merely updated in each second year; however, they stressed that changes of substance in economic policies and institutional settings should always be incorporated in the yearly report. In practice, therefore, it was likely that most REDs would have to be prepared annually.

METHODS OF SURVEILLANCE OVER EXCHANGE RATE CHANGES, AND NOTIFICATION PROCEDURES

All Directors asked for an evenhanded approach to surveillance and indicated that the Fund needed to play a more active role with respect to exchange rate changes. Some stressed the importance of more detailed and forthright discussion on exchange rate issues in Article IV consultations and in discussions on the world economic outlook, particularly when a stricter consultation schedule was being observed. In those exceptional circumstances where additional discussions with members seemed warranted, the existing procedures for dealing with such questions could be invoked.

To give effect to a more active role for the Fund and to help to ensure uniformity of treatment, most Directors saw merit in the "threshold" approach described in the staff paper, and there was broad support for implementing the approach on an experimental basis. Directors made a number of interesting and penetrating observations about the approach in the course of the discussion, and some indicated that they would be providing further, more detailed observations later. On the technical issue of the size of the numerical threshold, some Directors felt that a 5 per cent threshold would result in too large a number of information notices for such notices to be meaningful. Others felt that any change as large as 5 percent in real effective terms was important and should be subject to an information notice. On balance, particularly since the approach is to be adopted on an experimental basis, I would propose that we initially use a threshold of 10 percent.

Another technical issue concerns the appropriate starting point for the measurement of cumulative changes. Most Directors, while noting that there were weaknesses in the recommended approach, indicated a willingness to experiment with a starting point that was the latest occasion on which the Board had had an opportunity to discuss the member's exchange rate policy, which in most cases would be the most recent Article IV consultation.

On another matter, there was general agreement that, during the trial period, the staff should use its best judgment on the indicator of competitiveness to be employed and should incorporate a description of that indicator, with relevant data, in the Article IV consultation reports. The views of member countries on the measurement to be used would, of course, be taken into account.

On the content of information notices, Directors recommended a flexible approach and invited management to exercise discretion in deciding when to provide analysis and an appraisal. They agreed that the existing practice of notifying the Board of large discrete changes in nominal exchange rates should be continued, because it was important both for surveillance and for the general information of other members.
The management and staff will carefully examine and attempt to implement the proposal made by [Executive Director] for a periodic—perhaps quarterly—staff paper containing an indication of real effective exchange rates of members, flagging those cases where changes in the rate are particularly large. While it will be necessary to address a number of questions on the appropriate time perspective to be used, an effort will be made to provide a permanent flow of figures in a periodic brochure. Again, Directors indicated a willingness to rely on management's judgment of whether or not comments on those indicators should be provided or whether particular cases should be discussed in the Board.

**Surveillance over Members' Exchange Rate Policies [1984]**

(a) Review of Surveillance over Exchange Rate Policies

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

_Document No. 7645-(84/40)_
_March 12, 1984_

(b) Review of Implementation of Procedures for Surveillance

The Executive Board has also reviewed the procedures relating to the general implementation of the Fund's surveillance over member's exchange rate policies, as required by paragraph VI of Procedures for Surveillance in the document “Surveillance over Exchange Rate Policies” referred to in (a) above, including the procedures for the conduct of consultations under Article IV, which consultations shall comprehend the consultations under Article VIII and Article XIV, and approves the continuation of the procedures as described in SM/84/44, in the light of the Managing Director's summing up, until the next annual review, which shall be conducted not later than April 1, 1985.

_Document No. 7646-(84/40)_
_March 12, 1984_

Attachment to Decision No. 7646-(84/40)
Managing Director's Summing Up

In our review, Directors once again indicated the great importance they attach to the Fund's role in the field of surveillance. They also stressed that effective surveillance requires the full cooperation of members and that it must be conducted in an effective and evenhanded way.

The discussion encompassed two reviews: the biennial review of the basic document setting out the principles of surveillance and the annual review of the implementation of surveillance. I shall refer first to Directors' remarks on the key issues encountered in the conduct of surveillance that can be related to the
principles and procedures set out in the documents. Second, I shall refer to the remarks relating to the various methods through which surveillance is carried out: the multilateral aspects, Article IV consultations, and exchange rate monitoring.

**KEY ISSUES IN THE CONDUCT OF SURVEILLANCE**

In focusing on the substance of surveillance, a number of Directors stressed that the Fund should be more energetic in its efforts to make surveillance effective, evenhanded, and symmetrical. The following conclusions emerged from the discussions.

First, while many Directors recognized that the assessment of exchange rate policies was a very complex task, they stressed that it was incumbent on the Fund to form a view on the appropriateness of members' exchange rate policies, irrespective of the exchange arrangements chosen by individual members and of the member's need for Fund financial support. This principle is the core of Article IV. In practice, it is often difficult to determine with quantitative precision the magnitude of an exchange rate's "out-of-line." But if the Fund is convinced that a rate is out-of-line, it must express that view in the first instance to the authorities of the countries directly involved. A few Directors held the view that the staff sometimes seemed insufficiently flexible, and somewhat dogmatic in its views with regard to exchange rates, with a tendency to overestimate the effectiveness of exchange rate depreciation, particularly in developing countries and centrally planned economies.

Second, the staff's determination of the adequacy of the exchange rate policy in an individual country is not merely an econometric exercise; it is something that touches on the functioning of the international monetary system. Thus it is important that when the Fund staff is convinced of a maladjustment in exchange rates, it should seek agreement of the membership on that judgment and on the necessary policy changes. It can happen that national authorities have domestic goals and constraints that may result in an inappropriate exchange rate in the judgment of the Fund. In such instances, through Article IV consultations and other reviews, the matter is brought to the attention of the Executive Board; after discussion and Board agreement with the staff position, the country is informed. Beyond that, the effectiveness of the Fund's surveillance procedures requires that the members of this institution give active and broad support to the positions taken by the Fund.

Third, Directors supported the view that many of the international economic difficulties of recent years have been associated with the pronounced swings in exchange rates between major industrial countries, and with the repercussions of the low levels of economic activity and high interest rates prevailing in these countries on the rest of the world. Many Directors noted that to some extent these developments resulted from domestic policy stances in major industrial countries that, in their view, did not sufficiently promote the convergence of favorable economic conditions and that failed to take account of the implications for other countries and for the international monetary system as a whole. Most Directors felt that this failure to integrate international interests, rather than any deliberate
attempt to manipulate exchange rates or the international monetary system, was the real problem. Therefore, the Fund had to form a view on the domestic policies needed to foster a smooth working of the system and had to attempt to persuade its members to follow such policies. On the basis of these considerations, Directors agreed that the experience in the implementation of surveillance does not call for a revision of the principles and procedures set out in the documents, but calls for more active implementation.

METHODS OF SURVEILLANCE

Multilateral Aspects

Directors considered that the World Economic Outlook provided a valuable framework for analyzing global surveillance issues, and indeed considered it indispensable for evaluating the global effects of the economic policies of major countries. They welcomed the increasing emphasis on a medium-term approach and in particular on the development of medium-term balance of payments scenarios. They also called for increased analysis of the interaction of individual members' domestic policies, including the regional consequences of individual members' policies.

Directors considered it important that the Fund continue to place public emphasis on surveillance through different channels, such as publications and statements by the Managing Director. They also considered the more active role of the Fund in looking for solutions to the problems of external debt and protectionism in multilateral contexts to be essential. With regard to trade matters in particular, a number of Directors emphasized that the Fund's work could usefully enhance the GATT's activities while fully respecting the responsibilities of that institution.

Article IV Consultations

In view of the Fund's obligation to form a view on the exchange rate policies of members, Directors generally endorsed the practice in staff reports of providing clear appraisals of exchange rate policies. Several Directors felt that the Fund staff was still less explicit in its exchange rate policy pronouncements for large industrial countries than it was in the case of smaller countries. The view was also put forward that an appraisal of the exchange rate policy of a member in an Article IV consultation should be made, whenever appropriate, in a multilateral framework.

Directors welcomed the recent emphasis on medium-term scenarios in the analysis of external debt and encouraged the staff to make further progress in presentation and analysis, with possibly alternative scenarios on debt, and to make more explicit the assumptions that underlie these projections and the sensitivity of the scenarios to changes in assumptions. Directors also called for increased emphasis on the medium term when assessing underlying payments balances as part of the appraisal of members' policies even when external debt or the financing of external imbalances was not a major concern.
The need for continued development of staff analyses in consultation reports of issues related to protectionism and export subsidies was stressed by many Directors. These analyses should cover the practice not only of individual members but also, if necessary, of groups of countries and customs unions. It was felt that to the extent possible the economic costs of protectionist measures taken by individual countries or groups of countries since the last Article IV consultation should be quantified and that the impact of protectionism on domestic adjustment should be examined in relevant cases.

In the course of the discussion, a number of suggestions were made for further improving the analytical coverage in consultation reports of structural aspects, capital flows, openness of capital markets, the size and structure of government revenue and expenditure, barriers to direct investment, the noncentral government public sector, structural adjustment problems, aid to ailing industries, and labor markets. A number of Directors also proposed that consultation reports should follow up the main points made in the summing up of the previous consultation. These reports should recall the main recommendations of the Board as contained in the summing up and indicate whether appropriate measures had been taken.

As in the recent discussion of “Coverage and Curnrentness of Data,” Directors emphasized the crucial role of accurate data in consultation reports.

The marked increase in consultation frequency was welcomed by all Directors, who noted particularly the improved coverage of countries with Fund-supported programs. Directors recognized the efforts made in the last 18 months to reduce the backlog of overdue consultations, and considered that at the present time the problem of overdue consultations had been largely solved. Leaving aside cases involving security problems, at present only one member country was significantly behind in the consultation cycle. Directors reiterated their view that consultations should not be delayed on account of discussions on the use of Fund resources. A number of Directors believed that the Board should consider the Article IV consultation before turning to a request for use of Fund resources in those cases where the consultation was overdue. This is a very important policy recommendation.

Directors emphasized the need to carry out consultations on a timely basis in the future. In this regard, the system of advance specification of consultation cycles provides a useful framework. To help ensure that consultations are completed on time, we shall report to the Board on problems that may arise on a semiannual basis.

Directors broadly endorsed current practices in specifying consultation cycles. The suggestion was made that the criteria for the one-year consultation cycle be expanded to include members that wish to be kept on that cycle. Directors recognized that with such a work load, special efforts would be necessary to maintain the quality of consultation work. Therefore, the staff would continue to combine requests for use of Fund resources and periodic reviews with consultation reports. Some Directors supported the practice of selectively shortening, or even omitting, the papers on recent economic developments, particularly for countries on which economic information was amply available; but a number of other
Directors stressed the importance of those papers for members individually and collectively, and they were opposed to any reduction in the role or importance of these documents.

Directors encouraged the staff to bring consultations on closely related countries to the Board simultaneously, in order to avoid duplication of effort on common features and to better understand the interaction aspect.

**Exchange Rate Monitoring**

Directors considered that both the quarterly reports on indicators of real effective exchange rates and the notices on individual countries provided useful information, although, of course, the developments have to be carefully analyzed before reaching any policy-directed conclusions. Most Directors considered that the threshold for issuing information notices should continue to be 10 percent. Some questions were raised regarding the benchmark date.

Directors welcomed the staff’s intention to continue making improvements in the information notice system, and attached importance to making the coverage of the system as comprehensive as possible. In view of the importance of price, exchange rate, and direction of trade data for policy formulation, it is incumbent on country authorities, in consultation with the staff, to obtain the necessary data and to provide it to the Fund.

In sum, the Board felt that surveillance is an essential tool for the stability of the international monetary system. It considers that, despite the progress realized in the Fund’s work in this field, the insufficient convergence of economic conditions throughout the world requires, not necessarily changes in Fund procedures but, rather, strong political support from the membership.

There are still large differences of views on the way the exchange rate system is working and even larger differences of views on the way it should function. There are also differences of views on the way economic policies interact and, thus, affect the setting of prescriptions by the Fund. In a collective institution, these prescriptions can sometimes be difficult to express and even more difficult to implement.

We should continue to improve the quality and the persuasiveness of our analysis of policy interactions. It is only through the quality of these analyses that the Fund will enlist support for its recommendations. The Executive Directors can help the staff and management in this task by maintaining the high standards of their interventions relating to all surveillance matters.

**Surveillance over Members’ Exchange Rate Policies: Review of Implementation of Procedures [1985]**

The Executive Board has reviewed the general implementation of the Fund’s surveillance over members’ exchange rate policies, as required by paragraph VI of Procedures for Surveillance attached to Decision No. 5392-(77/63), adopted April 29, 1977, including the procedures for the conduct of consultations under Article IV, which consultations shall comprehend the consultations under Article VIII and Article XIV, and approves the continuation of the procedures as
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described in SM/85/65, in the light of the Managing Director's summing up, until the next annual review, which shall be conducted not later than April 1, 1986.

Decision No. 7939-(85/49)
March 25, 1985

Attachment to Decision No. 7939-(85/49)
Managing Director's Summing Up

Directors once again emphasized the great importance that they attach to the role of the Fund in the area of surveillance. They welcomed the emphasis of this year's review on questions related to the effectiveness of surveillance, particularly in view of the current international economic environment. Directors stressed in particular the need for a continued evolution of surveillance procedures to enhance the ability of the Fund to carry out its responsibilities in this area in an effective and evenhanded way, and made a number of suggestions for improvements in the way surveillance is implemented.

THE EFFECTIVENESS AND EVENHANDEDNESS OF SURVEILLANCE

The discussion of the question of the effectiveness of surveillance was wide ranging and we have heard some very thoughtful comments on this subject. The views expressed on the extent to which surveillance can be considered to be evenhanded in its implementation were particularly noteworthy, and I shall begin with an attempt to draw together the common threads of that discussion.

Directors all agreed that evenhandedness was essential to the effectiveness of surveillance. They noted the widely held view that the Fund was much stricter in its oversight of the policies of deficit developing countries than of those of other countries. Several Directors indicated their support for this view, but most agreed with the staff paper that this interpretation resulted from an insufficient distinction between the function of surveillance and other functions of the Fund, such as those involved in conditionality and jurisdiction over exchange restrictions. It was true that conditionality did involve particularly detailed attention to the policies of member countries engaged in Fund-supported adjustment programs. When countries faced financial crises, however, it was clear that policies needed to be corrected immediately, and in any case, the Fund was obliged to see that appropriate use was made of its resources. Most Directors thus agreed that surveillance, as such, had been evenhanded in its application. They stressed, however, that surveillance also needed to appear to be evenhanded. For that to be the case it must be seen to be effective with respect to the large industrial countries. Given the effects that developments in such countries had on the rest of the world economy, moreover, it was particularly important that it be effective for those countries.

Directors considered that surveillance in fact had been much less effective than it should have been. Directors did note the important role that surveillance had played in bringing key policy issues to the attention of the authorities and keeping them under active discussion. It was also possible to cite many instances where
policy decisions in member countries clearly had taken account of the views expressed by the international community through the Fund's surveillance process.

More generally, however, it was clear that there remained substantial divergences between the policies actually pursued by some member countries and those advocated by the Fund membership collectively. A number of references were made by Directors to the fact that fiscal policy in the United States continues to diverge from what in the view of those Directors would be optimal in terms of its effects on the world economy, as well as on the U.S. economy itself. The continuing inadequacy of corrective policies in other industrial countries and in many developing countries was also stressed. Some Directors expressed the view that what was needed was more explicit guidance for members on the types of exchange rate and other policies that were consistent with the objectives of the Fund than was provided in the surveillance decision or, indeed, in the Articles themselves. Directors underlined the fact that while we must continually endeavor to sharpen our analysis and to improve our procedures, the basic issue was not procedural. Rather it was the willingness of member countries to adapt their policies in light of the views expressed by the international community.

Before turning to Directors' views on the major ideas for enhancing the effectiveness of surveillance in this area noted in Section VI of the staff paper, I will sum up the discussion of various issues emerging from the experience in 1984 with the implementation of surveillance.

**Issues Arising from the Implementation of Surveillance in 1984**

(i) The Analytical Basis of Surveillance

Directors considered that the analytical framework provided by the world economic outlook exercise continued to be an extremely useful basis for evaluating the global impact of the economic policies of the major countries. They welcomed the increasing emphasis, both in the world economic outlook and in Article IV consultations, on the medium-term implications of members' policies. Directors also noted the desirability of further development of analytical techniques in the key policy areas. In this connection, they stressed the need for more comprehensive analysis of the international implications of country policies. They also noted the need for a better understanding of the ways in which financial policies and problems of structural adjustment interacted internationally to affect exchange rates.

(ii) Article IV Consultations

Directors considered that Article IV consultations were the key element of the surveillance process. They welcomed the increased coverage in Article IV staff reports, both of important policy issues and of technical aspects, such as the quality of statistics and relations with the World Bank. They nonetheless encouraged the staff to be economical in reporting, to avoid blurring the focus of staff reports on the key issues. Many Directors felt that, given the heavy work...
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load, the staff should be free to experiment with abbreviated reports on recent
economic developments (REDs) in some cases.

Directors welcomed the improvement in consultation scheduling that has
occurred since the implementation in 1983 of the system of advance specification
of consultation cycles. In this connection, Directors considered it important that
the Fund focus its efforts on those situations most in need of attention, and
suggested that more differentiation in specification of cycles would be appropri­
ate. In particular, all of the largest countries (several figures have been mentioned
to define this group, and on that basis, I would say at least the 25 largest members)
should be on the standard cycle. On the other hand, for small countries (other than
countries with programs with the Fund or where there were questions about
balance of payments viability), longer cycles up to two years would generally be
appropriate, although where such members valued annual discussions with the
Fund, they should be entitled to request the standard cycle. Some Directors
suggested that informal staff visits for policy discussions midway between full
consultations might be a useful way to accommodate the preferences of some
members in such cases, while still keeping the work load within manageable
proportions.

(iii) Monitoring of Exchange Rates

Directors considered that experience had been broadly satisfactory with the
system of monitoring exchange rate developments through notifications to the
Executive Board of changes in exchange arrangements and through information
notices relating to large movements in real effective exchange rate indices,
although some Directors cautioned against the temptation to rely too heavily on
mechanical indicators of that sort. Many Directors felt that exchange rate
developments in large industrial countries deserved perhaps more frequent
attention, and a number of Directors supported a reduction in the threshold for
information notices for such countries. But after having looked at the tally, I
would conclude that the Board has not called at this point in time for a change in
the information notice system.

SUGGESTIONS FOR IMPROVING THE EFFECTIVENESS OF SURVEILLANCE

I turn now to the discussion of the major ideas described in Section VI of the
staff paper. In general, Directors believe that we should explore every possible
avenue for improving the effectiveness of surveillance.

First, while some Directors were quite negative with regard to the use of
objective indicators, there was a broad-based interest in exploring the idea of
making greater use of objective indicators as an instrument of Fund surveillance,
particularly vis-à-vis major industrial countries. Most Directors stressed, how­
ever, that there would be considerable difficulty in establishing such indicators
and agreeing with members on appropriate values for them. Directors therefore
urged the staff to take an experimental approach in terms both of further
development in the conceptual approach to be followed and of exploration of the
concept with interested authorities. I conclude that, for the time being at least, the
use of such indicators in particular cases where they might be appropriate and acceptable would be limited to providing a basis for reviewing, in the course of an Article IV consultation, developments against the background of the conclusion of the previous one.

Second, most Directors reacted negatively to the idea of a major move toward greater publicity in connection with Article IV consultations. They emphasized that the confidential relationship between the Fund and its members has been one of the most important elements of the consultation process, and they believed that publicity would involve a change in that practice that could have serious consequences for the candor and frankness of the policy discussions between the Fund and its members.

In the same vein, most Directors expressed reservations—although some of them were very interested in the idea—about the release of staff reports, and were concerned that such a practice could adversely affect the frankness and usefulness of these reports. For, I think, similar reasons, the reaction was negative at this point in time to the idea of the Managing Director making public statements following the conclusion of Article IV consultations. At the same time, I noted the Board’s general support for the manner in which I have been expressing my views and positions on matters of Fund concern in my public addresses. I should also note that most Directors were open to the wider release, including publication, of REDs with the approval of the member concerned.

Third, Directors believed that there was considerable scope for expanded follow-up to consultations on the side of both the Fund and country authorities. They considered that the current practice in Article IV staff reports of including reviews of developments against the background of the previous consultation should be further developed as a means of assessing the effectiveness of the consultation process, by giving indications of the weight the authorities attached to the views of the Fund. Directors strongly supported more “internal publicity” among the authorities of member countries themselves for the findings of the Fund. It was noted approvingly that in many member countries authorities at the ministerial level participate in the final policy discussions with the mission. The staff will continue the practice of listing in its reports the principal representatives of the member country taking part in the discussions.

It was also considered desirable that management communicate directly with Ministers of Finance regarding the outcome of the Fund’s review, but only in carefully selected cases where the Executive Board felt high-level consideration to be particularly important because of the urgency of the policy views expressed. In that context, it was noted that the Managing Director frequently has contacts with the highest authorities of member countries, in Washington or abroad, as well as through exchanges of communications and telephone conversations, which will of course continue.

Fourth, Directors encouraged the use of supplemental consultations with member countries in selected circumstances. A wide range of detailed views was expressed on this subject. Several Directors suggested that supplemental consultations might be appropriate for members in arrears to the Fund, members without
current programs but with large financial obligations to the Fund, or members making prolonged use of Fund resources. Supplemental consultations could, in the view of several Directors, also be triggered as a result of major policy actions by members. At their discussion on March 18 on trade policies, Directors asked that the Board be notified of major new developments in that area, and such notifications, as with the current exchange rate information notices, could well lead to supplemental consultations if Directors so requested. They could also take place some time following the conclusion of an Article IV consultation that left serious doubts about the appropriateness of a member’s policies.

Finally, there was a wide-ranging discussion of various issues involved in enhanced surveillance of the policies of member countries involved in multiyear rescheduling arrangements. Directors believed that the Fund should be selective in acceding to requests for enhanced surveillance, and some Directors cautioned against the involvement of the Fund in such arrangements for too long a period of time. A number of them considered that in practice the procedure would be appropriate mainly for countries where strong adjustment policies were well under way. Otherwise, the Fund would continue to consider the endorsement of the country’s adjustment program in the context of a stand-by or an extended arrangement as the normal means of providing the necessary signal to commercial banks and other sources of finance. Most Directors considered that release of staff reports to banks in such cases would be acceptable if the country requested it and if it was necessary for the restructuring to take place. Directors emphasized that staff reports provided to commercial banks in cases of enhanced surveillance should not be, and should not be seen to be, of such a character as to provide on/off signals from the Fund. Directors, moreover, reiterated the view expressed during the Board’s discussion on March 20 of external indebtedness that commercial banks should take full responsibility for their country-risk assessments. More generally, Directors cautioned that, under enhanced surveillance, the Fund should not be seen as either formally endorsing the member’s policies or intervening too deeply in the relations between debtor countries and commercial banks. We have taken very careful note of the many issues raised by Directors regarding the access to and procedures for enhanced surveillance. The staff will reflect on them and we will return to these matters as experience is gained on a case-by-case basis.

In the course of their discussion, Directors indicated their awareness of the difficulties of embarking on new procedures at a time when Board, management, and staff all face very heavy work loads, and urged that ways be found to mitigate the burden. Some of the ideas supported by the Board today could be implemented without too much difficulty, but others would involve some considerable effort. What I would propose is that over the next few months management and staff consider Directors’ ideas both to gain experience with how they could be implemented in practice and to explore their implications for the work load and for the budget.

The Executive Board will return to the matter of surveillance, taking stock of all
the ideas that have been explored, and of suggestions put forward by Directors, including the issue of publicity.

Appendix C. Enhanced Surveillance

Extract from Managing Director’s Speech
on May 10, 1985 Before the Annual Spring Membership Meeting
of the Institute of International Finance, Washington, D.C.

To begin with, the Fund will continue to play an active role through its support for countries’ adjustment policies and its surveillance of their economies.

As countries progress toward renewed access to financial markets, it is likely that there will be increased emphasis on the Fund’s role as a financial catalyst and on its role in providing continuing analysis and policy advice. In this connection, certain countries have asked the Fund to conduct enhanced surveillance of their economies, to facilitate banks’ monitoring of their progress toward a viable external position in the absence of a Fund-supported program.

The procedure of enhanced surveillance is still developing, and doubtless will evolve with experience on a case-by-case basis. Nonetheless, some of the opportunities and challenges it presents to member countries and their creditors are already clear. The cornerstone of enhanced surveillance is the member country’s preparation of a quantitative financial program that will set out major macroeconomic targets and policy objectives over the year ahead. Needless to say, the success of such programs will depend, above all, on the commitment on the part of the authorities concerned to carry them out. The Fund will evaluate such programs, assessing the consistency of the policies adopted with the objectives and their compatibility with sustained growth and progress toward a viable external position. Half-yearly consultation reports will monitor the progress achieved in the implementation of programs, and will evaluate countries’ economic performance.

Creditors, for their part, will need to weigh these assessments, together with other available information, before arriving at their own judgments about the economic performance of a country and making their own credit decisions. Fund staff reports under enhanced surveillance cannot be relied upon to provide “on/off” indications for financing. That would be inconsistent with progress toward more market-related decision making by creditors. Enhanced surveillance can support banks’ risk assessment procedures, but cannot substitute for them. For this procedure to evolve in a manner that can best serve the interests of all parties, it will be essential that the adjustment being undertaken is supported by “spontaneous” financing on a flexible and continuing basis, as justified by the particular circumstances of the country concerned. (IMF Survey, Vol. 14 (May 27, 1985), pp. 162–65, at p. 164.)
The Chairman’s Summing Up of the Discussion
of the Role of the Fund in Assisting Members with
Commercial Banks and Official Creditors
Executive Board Meeting 85/132 – September 4, 1985

GENERAL REMARKS

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

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

CRITERIA AND PROCEDURES

a. Criteria for the Adoption of Enhanced Surveillance

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

First, at the request of a member country, who must initiate the procedures;
Second, in cases where a good record of adjustment has been shown;
Third, in cases in which a MYRA is needed to normalize market relations and to facilitate the return to voluntary or spontaneous financing;
Fourth, in cases where the member is in a position to present an adequate quantified policy program in the framework of consultations with the Fund staff, which are part of the procedure of enhanced surveillance.
Appendix C

b. Length of the Fund's Involvement

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

c. Trigger Mechanisms

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

d. Contents and Distribution of Staff Reports

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

e. Involvement of the Executive Board

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

g. Review of the Policy on Enhanced Surveillance

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

Enhanced Surveillance – Procedures for Transmittal of Staff Reports

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

Decision No. 8222-(86/45)
March 12, 1986


Proposals to Improve Surveillance

When the decision on surveillance was adopted in April 1977 it was recognized that it would not be possible to produce a comprehensive set of guidelines applicable to all situations that might arise. Accordingly, the decision that established the principles of surveillance also specified that they should be reviewed at two-year intervals, or more frequently. A recurrent theme of each subsequent review has been the need to make surveillance effective. The most recent review, concluded on February 12, 1986, focused on several proposals made recently to improve the functioning of the international monetary system and to enhance the implementation of surveillance procedures, most prominently in the reports of the Group of Ten and the Group of Twenty-Four.
These reports agreed on a number of key points regarding the implementation of surveillance: first, the function of surveillance is central to the role of the Fund; second, surveillance should be evenhanded and symmetrical; third, the achievement of this symmetry requires particularly close scrutiny of the policies of countries that are important in the international financial system; and fourth, surveillance has so far been less effective than would be desirable in influencing national policies and in promoting economic and financial conditions conducive to exchange rate stability.

The Executive Board endorsed these broad conclusions of the two reports. It noted that the shortcomings highlighted in these reports—in particular the concerns about evenhandedness and effectiveness—had in large measure been rooted in the fundamental changes that had occurred in the international economic and financial environment since the widespread adoption of floating exchange rates. They also reflected the difficulty that individual countries had in fully appreciating the benefits to be gained from framing their domestic policies in the light of a set of consistent international objectives. The perceived asymmetry in the effectiveness of Fund influence—meaning that conditionality in the use of the Fund resources had significantly affected developing countries, while surveillance had had little practical effect on the countries with a major impact on the world economy—had increased since the adoption of floating exchange rates by several major countries. The Board felt that an essential requirement for effective surveillance was a willingness on the part of all members to implement policies in a way that took full account of both their interdependence within the international monetary system and their mutual self-interest in the improved operation of the system.

Part of the responsibility for shortcomings in the functioning of the system might, in the Executive Board's view, also be attributed to the way in which the surveillance mechanism has operated. Particular importance was thus attached to reviewing possible means of improving the surveillance mechanism. The Executive Board considered a number of proposals, including some that focused on improvements in the procedures through which surveillance was implemented.

First, the scope of surveillance could be widened to include the broader principles of oversight by the Fund over members' economic policies, thus recognizing explicitly that exchange rate movements that cause international concern are more often than not the unintended result of divergences and inadequacies in domestic policies rather than the deliberate consequences of policies aimed at influencing conditions in the foreign exchange market. Second, indicators—not necessarily quantified, rigid indicators, but more systematic guidelines than those specified in the existing surveillance decision—could be used to characterize a stance of policies and to help the detection of inconsistencies and deviations from appropriate policies. Third, the implementation of existing surveillance procedures could be strengthened along the lines of some of the detailed proposals in the reports of the Group of Ten and Group of Twenty-Four. These proposals, summarized in Table 13, can be grouped broadly into three categories: those aimed at improving the analytical basis of surveillance,
those designed to enhance the multilateral setting of surveillance, and those intended to strengthen the influence of the consultation process.

As regards the analytical basis of surveillance, a number of proposals met with widespread support. It was agreed that there was need to broaden the coverage of policies subject to surveillance and to integrate further the assessment of exchange rates and domestic policies within a medium-term framework. Specifically, exchange rate developments should be viewed in the context of an assessment of fiscal, monetary, trade, and structural policies. Moreover, a medium-term framework was seen as essential to assess the consistency and sustainability of members' policies. In this context, regular consultations provide a useful opportunity to assess the adequacy of available data and to stress the main areas of needed improvement. Finally, it was emphasized that staff reports for Article IV consultations should provide candid appraisals of members' policies, making clear the analytical basis of policy judgments; when the staff disagreed with a member's policies, precise suggestions for policy change should be made.

Considerable support was also expressed for proposals to strengthen the multilateral setting of surveillance. While the basis for an overall assessment of international economic developments and prospects is provided by the twice-yearly world economic outlook exercise, it was felt that the usefulness of this review could be enhanced by a more explicit analysis of economic interactions among major countries. The inclusion of a separate chapter in the World Economic Outlook devoted to an analysis of the international repercussions of policies and developments in the larger countries should improve the framework for reviewing policy issues in a multilateral setting.

A suggested means for strengthening the conduct of Article IV consultations was through direct contact, at the conclusion of certain Article IV consultations, between the Managing Director of the Fund and the finance minister of the country concerned. This could be helpful in those cases where high-level consideration was thought to be particularly necessary because of the importance of the issues involved or the urgency of the need for policy action. Second, the continuity of the consultation process could be strengthened through a review in subsequent reports of policy recommendations made by the Fund in the course of a consultation. Third, the coverage of information notices used to monitor key developments in the period between Article IV consultations could be broadened. At present, these notices cover only significant changes in real effective exchange rates and in trade policies. Fourth, greater use could be made of the supplemental surveillance procedure, whereby the Managing Director can initiate an informal and confidential discussion if he considers that a modification in a member's exchange arrangements or exchange rate policies, or the behavior of the exchange rate for its currency, may be important or may have important effects for other members.

These various issues related to surveillance, together with a report by the Managing Director of their initial consideration by the Executive Board, were reviewed by the Interim Committee in April 1986. The Committee reaffirmed the key role that Fund surveillance needs to play in the functioning of the international
monetary system. The need to strengthen the multilateral framework of surveillance, which had been a particular focus of the reports of the Group of Ten and the Group of Twenty-Four, was also a central element of the Committee's review of means to improve surveillance. The Committee noted in this context that increased emphasis would be given in the world economic outlook exercise to policy interactions among industrial countries in order to strengthen the basis for assessing the international repercussions of the policies and objectives of the major industrial countries, and to help promote the further development of recent initiatives to enhance policy coordination among these countries.

The Interim Committee asked the Executive Board to consider ways in which its regular reviews of the world economic situation could be further adapted to improve the scope for discussing external imbalances, exchange rate developments, and policy interactions. The Committee suggested that an approach worth exploring was the formulation of a set of objective indicators related to policy actions and economic performance, having regard to a medium-term framework. Such indicators might help identify a need for discussion of countries' policies.

Subsequently, at the Tokyo Economic Summit in May 1986, participants reaffirmed their undertaking made in 1982 to cooperate with the Fund in strengthening multilateral surveillance, particularly among the countries whose currencies constitute the SDR basket. They requested that, in conducting such surveillance and in conjunction with the Managing Director of the Fund, their individual economic forecasts should be reviewed, taking into account such indicators as GNP growth rates, inflation rates, interest rates, unemployment rates, fiscal deficit ratios, current account and trade balances, monetary growth rates, reserves, and exchange rates.
NOTES

References to provisions of the Fund’s Articles of Agreement are to the present Articles.

The six earlier pamphlets in this series are referred to by the number and date of the pamphlet, as follows:

Pamphlet No. 19 – Floating Currencies, Gold, and SDRs: Some Recent Legal Developments (1976).

Pamphlet No. 22 – Floating Currencies, SDRs, and Gold: Further Legal Developments (1977).


1. Pamphlet No. 36, pp. 1–14 and 93–96.

2. For the full text of Decision No. 6631-(80/145)G/S, dated September 17, 1980, see Selected Decisions of the International Monetary Fund and Selected Documents, Eleventh Issue (Washington, 1985), pp. 284–85. (Hereinafter referred to as Selected Decisions); Pamphlet No. 36, p. 95.


6. The changes that took effect on that date are discussed in Pamphlet No. 36, pp. 14–20.

7. Ibid., pp. 19 and 97.

8. Ibid., pp. 16–17.

9. The method of calculating the interest rate is this: the interest rate on an instrument in the interest rate basket is multiplied by the number of units in the basket of the currency in which the instrument is denominated; the product is multiplied by the value of the currency in terms of the SDR; the resulting products for the five currencies are added together.
Notes (pages 6–15)

10. Article XX, Section 3.
11. Article XX, Section 1.
12. Article XX, Section 2.

14. Article XX, Section 5.
15. (1) Participants have various obligations to “surrender,” that is, use SDRs, in payments to the Fund; one such obligation is to pay charges on the amount by which allocations exceed holdings of SDRs. Other obligations are imposed by Article III, Section 3(a); Article V, Section 9(d); Article VII, Section 1(ii); Article XII, Section 6(e); and Article XVI, Section 2, among other provisions.

(2) Cancellation of SDRs by the Fund under Article XVIII, Section 2 can be considered a form of compulsory surrender of SDRs by participants to the Fund. A participant is compelled to accept SDRs from another participant in accordance with the designation process of Article XIX, Section 5. This obligation is one of the two fundamental obligations on which the SDR system rests. The other obligation is that of the Fund to designate a participant to accept SDRs if another participant requests the designation of a transferee.

16. Article XX, Section 1.
17. Article XX, Section 2.
18. Article XX, Section 5.
19. Article XX, Sections 2 and 5.
28. See note 26, Article VII, paragraph 8.
29. Article V, paragraph 2.
30. Article 13, paragraph 5.
31. Article 16.
32. See note 27, Article 4, paragraphs 4(a)-(d).
33. Ibid., paragraph 4(3).
35. Ibid., pp. 31-32.
39. Ibid.
41. Ibid., Chapter II, Article 6, p. 20.
42. The text is based on the article by Melchiade Yadi, “La Communauté Economique des Pays des Grands Lacs,” Studia Diplomatica (Brussels), Vol. 34, No. 6 (1981), pp. 709-51.
43. Pamphlet No. 33, pp. 43-44.
46. Bonds of this length have been referred to sometimes in the field of export credits as medium-term.
49. Ibid., p. 10 (Decision No. 5392-(77/63), April 29, 1977).
50. Attachment to Decision No. 7646-(84/40), March 12, 1984, Managing Director’s Summing Up (reproduced in Appendix B of this Pamphlet), pp. 112-13.
51. Ibid.
53. The Fund's index of competitiveness can be given normative effect by a member. For example, the Norwegian Ministry of Finance on August 12, 1985 published rules regarding the international value of the Norwegian krone, pursuant to Royal Decree of August 9, 1985 by which the King had delegated certain of his powers to the Ministry in accordance with Section 4, second paragraph of the Act of May 24, 1985, relating to Norges Bank and the Monetary System. Section 1 of the Rules sets forth the composition of the exchange rate index and the weights, consisting of 14 currencies. Paragraph 2 of Section 1 provides in translation that: "The weights are to be reassessed at certain intervals and may also be reassessed in connection with changes in the competitiveness weights of the International Monetary Fund." (Bank of Norway, Economic Bulletin, 1985/3, Vol. 56 (September 1985), pp. 230–31, at p. 231; see also pp. 206–207.)

54. Article XII, Section 4.


56. Ibid.


59. Attachment to Decision No. 7646-(84/40), Managing Director's Summing Up (reproduced in Appendix B of this Pamphlet), pp. 111–15.

60. International Monetary Fund, International Monetary Reform, Documents of the Committee of Twenty (Washington, 1974), pp. 24–28. (Hereinafter referred to as Documents of the Committee of Twenty.)

61. Ibid., p. 19.


65. "Supplement on the Group of 10 Deputies' Report," IMF Survey, Vol. 14 (July 1985), pp. 1–16. The Group of Ten had its origin in the negotiation of the Fund's General Arrangements to Borrow (GAB), which were set forth in a decision of the Fund on January 5, 1962 and which became effective on October 24, 1962. The members are Belgium, Canada, France, the Federal Republic of Germany, Italy, Japan, the Netherlands, Sweden, the United Kingdom, and the United States. Switzerland has met regularly with the Group as its eleventh
member since December 26, 1983, when the GAB was enlarged to include Switzerland as a full participant.

66. Article IV, Section 2(b).


68. _Ibid._, p. 3, paragraph 12.

69. _Ibid._, pp. 3-4, paragraphs 13-22.

70. _Ibid._, pp. 4-5, paragraphs 23-31.

71. _Ibid._, p. 5, paragraphs 31-32.

72. _Ibid._, pp. 6-8, Chapter III, paragraphs 34-54.

73. _Ibid._, p. 6, paragraph 39.


76. _Ibid._, pp. 7-8, paragraphs 49-54.


79. _Ibid._, pp. 8-10, Chapter V, paragraphs 72-89.

80. _Ibid._, pp. 7-8, Chapter IV, paragraph 63.


82. _Ibid._, pp. 7-8, paragraph 68.

83. _Ibid._, pp. 8-9, Chapter V, paragraph 78.

84. See _Documents of the Committee of Twenty_. pp. 8-13.


86. _Selected Decisions_, pp. 11-12.

87. _Ibid._, p. 11.

88. Paragraph 23 of the _Report of the Working Group on Exchange Market Intervention_ (called the Jurgensen report after its Chairman) of March 1983 describes "disorderly conditions" as follows:

While it has never been possible to devise a common, comprehensive operational definition of "disorderly markets," authorities in each country have intervened at times when they perceived unusual and undesirable patterns of behaviour in exchange markets. Such patterns of behaviour have included a substantial widening of bid-asked spreads, large intra-day exchange rate movements, perceptions that trading has become "thin" or highly uncertain, and at times, judgements that market psychology was beginning to generate self-sustaining exchange rate movements. All countries have intervened occasionally in order to offset the immediate destabilising impact of sudden events of an essentially non-economic nature. (pp. 8-10)
Table 1 of the report (p. 9) lists 14 objectives of intervention pursued at various times by Summit countries during the period subsequent to the par value system. Three subheadings are listed under "Countering disorder," and two subheadings appear under "Resisting rate movements ('which bear no relation to the fundamentals')". Paragraph 22 (p. 8) states: "All seven countries have had one objective in common: that of countering disorderly exchange market conditions as part of their commitment to promoting a stable system of exchange rates, in accordance with their obligations under Article IV of the Articles of Agreement of the International Monetary Fund as amended in 1978. But there is no unique definition of what conditions in the market are indicative of disorder."


2. The consultation process initiated at Versailles will be enhanced to promote convergence of economic performance in our economies and greater stability of exchange rates, on the lines indicated in an annex to this Declaration. We agree to pursue closer consultations on policies affecting exchange markets and on market conditions. While retaining our freedom to operate independently, we are willing to undertake coordinated intervention in exchange markets in instances where it is agreed that such intervention would be helpful.

The Annex, entitled “Strengthening Economic Cooperation for Growth and Stability,” contains this statement:

3. *Exchange Rate Policy*. We will improve consultations, policy convergence and international cooperation to help stabilize exchange markets, bearing in mind our conclusions on the Exchange Market Intervention Study.


96. David C. Mulford, Assistant Secretary of the Treasury for International Affairs, before the Senate Committee on Banking, Housing, and Urban Affairs, Subcommittee on International Finance and Monetary Policy, October 23, 1985, in “The Group of Five Meeting and Announcement: Context and Perspective,” *Treasury News* (Washington), B-326, p. 8. See also the following statement by Karl Otto Pöhl, President of the Deutsche Bundesbank, in Frankfurt am Main on November 4, 1985:

There was agreement in New York on 22/9 — as is stated in the communiqué — that an appreciation of the currencies of Europe and in particular an appreciation of the yen vis-à-vis the US dollar was desirable. In this context, interventions by central banks on the foreign exchange markets were considered to be appropriate and useful under certain circumstances also by the United States, on whose initiative, incidentally, the New York meeting was arranged. This constitutes a remarkable change in the attitude of the United States and we welcome it. But it would be wrong to draw the conclusion from this that some kind of ‘target zones’ or fixed levels for the exchange rate of the US dollar had been laid down in New York. I believe that it was clear to all those involved that any such attempt would be doomed to fail from the start owing to the sheer size of the international financial markets. Apart from this, probably no country would be prepared to accept the consequences of defending specific exchange rates for its monetary and fiscal policies. But I nevertheless consider it to be a step forward that the United States now attaches greater importance to the exchange rate of its currency and is willing to engage in closer co-operation on the foreign exchange markets, as we have advocated for a long time.

Since the meeting in New York interventions have been carried out on the foreign exchange markets on a considerable scale, albeit not primarily by the Bundesbank but by the United States and Japan, in contrast to September 1984 and late February 1985. To my mind, this is appropriate considering that the foreign trade imbalances that are intended to be influenced by corresponding changes in exchange rates are first and foremost a problem between the United States and Japan. In the first nine months of 1985 alone the surplus on Japan’s bilateral balance of trade with the United States totalled some $27 billion.


99. Article IV, Section 2; Article IV, Section 4; Article VIII, Section 7; Article XXII; Schedule D, paragraph 2(a).
Notes (pages 37–49)

101. Ibid., p. 238.
102. Pamphlet No. 40, p. 33.
106. Ibid.
109. Ibid., pp. 80–82, paragraphs 3.8–3.62.
113. Ibid., p. 1271.
115. Ibid., pp. 54–55, paragraphs 5.14–5.17.
117. Ibid., p. 28.
120. The Council’s calculation resulted in FF 5.633 per unit of account for the period August 1, 1975 to July 31, 1977 and FF 5.7806 per unit for the period August 1, 1977 to October 18, 1977. The applicants claimed FF 6.73056 per ECU.
121. [1978] 3 W.L.R. 804. See Gold, Pamphlet No. 33, pp. 77–79. In citing
the two cases, the Advocate General was making the point that the rate of exchange at the date of payment applied to both contractual and noncontractual claims.


126. 15 U.S.C. 77a et seq.


129. In *Les Rapides Savoyards S.à.r.l. and Others v. Directeur Général des Douanes et Droits Indirects* (Case 218/84), [1985] 3 C.M.L.R. 116, the issue was the customs duty that France could impose on an importation of goods from Switzerland under Protocol 3 of the European Economic Community (EEC)-Switzerland Free Trade Agreement, and this issue raised the question of the date as of which to apply exchange rates. Some American components in the manufacture of the goods in Switzerland had been imported into that country from France and some directly from the United States. To enjoy the preferential tariff under the Agreement, the Swiss customs authorities had to certify that the value of non-European components was below 5 percent of the finished product. The Swiss did make this certification, basing it on the exchange rates at the date of importation of the American components into Switzerland. The French customs authorities denied the preferential tariff on the ground that the value was more than 5 percent on the basis of exchange rates at the date of importation into France. The U.S. dollar had appreciated in the meantime. The Advocate General, the Italian Government, and the Commission argued that the Swiss valuation was conclusive, because, if it were not, fluctuating exchange rates would make it impossible for an exporter to know, before the date of exportation, what the rate of duty was going to be, and it would be difficult for the exporter to quote firm prices. Furthermore, the applicable rate of duty could vary among Member States of the Community in relation to Switzerland because of the development of exchange rates. The European Court held the Swiss certification of value to be conclusive for the French customs authorities but on the basis of the literal interpretation of the Agreement and not because of the fluctuation of exchange rates. The French authorities were entitled to apply the exchange rate between the French franc and the Swiss franc at the date of importation into France to determine the value of the imported goods but not the rate of duty payable when the rate depends on the Swiss certification of the value of non-Swiss components.
Notes (pages 55–82)


131. 646 F.2d 434 (10th Cir. 1981).


133. The contention was that the court could make this determination under Utah’s enactment of the Uniform Commercial Code (U.C.C.), Utah Code Ann. §70A–2–305(1) (1980).


139. Ibid.

140. 646 F.2d at 440.

141. Pamphlet No. 22, pp. 7–14.


144. Ibid., p. 94.

145. See p. 128 of the article by Laura Stevenson Conrad cited in note 132.


147. Ibid., p. 339. (The reference is to Law Reform Committee, The Powers and Duties of Trustees, published in Cmd 8733, October 1982.)


151. R. K. Ashton, “Foreign Exchange Gains/Losses Reconsidered,” Business Law Review (London), Vol. 3 (July 1982), pp. 218–20, at p. 219. Note also John Chown, “The Tax Treatment of Foreign Exchange Fluctuations in the United States and the United Kingdom,” George Washington Journal of International Law and Economics, Vol. 16 (No. 2, 1982), pp. 201–37: “The relevant law in both countries is both complex and unsatisfactory. It typically is based on statutes and cases that were enacted and decided when currency fluctuations were not major problems. The American literature, in particular, has tended to assume that other currencies, and not the dollar, fluctuate.” (p. 235)


154. In the accounts of each year the monetary assets and liabilities denominated in a foreign currency were valued in sterling at the exchange rate at the balance sheet date, but as the result of matching, no profit or loss was shown.

Transactions involving foreign currency can have surprising and seemingly illogical ramifications for federal income tax purposes. Furthermore, because the courts and the Internal Revenue Service have considered a limited number of foreign currency transactions, many issues cannot be resolved with any certainty at all.

The trouble with foreign currency is that economically it is a medium of exchange but for tax purposes, in a system where everything must be measured by reference to the value of the U.S. dollar, foreign currency must be treated as property. Yet, the “property” treatment cannot be a perfect fit and the tension between the economic characteristics of foreign currency and the attempt to treat it as property for tax purposes produce rules which are not easy to explain. (Footnote omitted.)

158. Ibid., p. 556.
According to three members of the court:

In the argument emphasis was given to the notion that the money stock of a finance company is similar to the trading stock of a trading company. There are some obvious similarities. However, there are some differences. Money is not dealt with in specie as a commodity and money is not included in the definition of "trading stock" for the purposes of the Act—see s 6. Despite these differences, what is of immediate importance is the strong similarity between the getting in and the turning over of trading stock by a trading company and the borrowing and on-lending of money by a finance company. This similarity is so strong as to suggest that just as exchange gains and losses on the acquisition of trading stock are to be included in the assessable income of a trading company, like gains and losses in connexion with the borrowing and repayment of loans by a finance company, are also to be included in assessable income (p. 677).


163. Pamphlet No. 40, p. 77.


167. Ibid.


170. A higher limit applied if the consignor of cargo declared a higher value for it when the cargo was handed to the carrier and paid the surcharge that was exigible.

171. 49 U.S.C. §1301 et seq.


173. 80 L Ed 2d, p. 278.

174. 0.888 671 gram of fine gold (Article XXI, Section 2 before Second Amendment).

175. 80 L Ed 2d, p. 280.

Notes (pages 72–80)

178. 80 L Ed 2d, p. 282.
179. Ibid., p. 283.
180. Ibid.
181. Ibid., p. 284.
182. Ibid. (footnotes omitted).
183. Ibid.
184. Ibid. The computation for converting Poincaré francs into U.S. dollars would be as follows on the basis of the value of the SDR on March 23, 1979, the date the cargo was delivered to TWA: 1 Poincaré franc (90 percent fine gold) = 0.0655 gram of fine gold; 1 Poincaré franc (100 percent fine gold) = 0.05895 gram of fine gold; 1 SDR (gold value on March 31, 1978) = 0.888671 gram of fine gold; the number of francs in 1 SDR = 0.888671/0.05895 = 15.075, rounded to 15. The Warsaw Convention limit of 250 francs per kilogram converted to SDRs = 250/15 = 16.67 SDRs per kilogram, rounded to 17 SDRs. The dollar value of 1 SDR on March 23, 1979 = 1.28626; 17 SDRs per kilogram times 1.28626 = $21.87 per kilogram. (SDR 17 per kilogram was equal to approximately $17.99 on April 17, 1984.)

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185. 80 L Ed 2d, p. 285.
186. Ibid., p. 284.
188. Ibid., p. 285.
189. Ibid., pp. 287–301.
190. Ibid., p. 285.
191. Ibid., p. 286.
192. Ibid., p. 285, n. 31. In the United Kingdom, rates for translating the unit of account into sterling are made from time to time by the Secretary of State under Carriage by Air (Sterling Equivalents) Orders. The following comment has been made on this practice:

The exercise of the Secretary of State’s discretion in the making of these orders has never yet been challenged, but it is not impossible that such a challenge might succeed, in accordance with the principles of administrative law. Certainly, the further the levels of limited liability become removed from the levels of compensation which would be available to a plaintiff under unlimited principles, the greater the incentive for such a challenge. (Peter Martin and John Balfour, “Carriage by Air—Limited or Unlimited Liability,” Business Law Review (London), Vol. 4 (July 1983), pp. 169–71, at p. 170).


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Notes (pages 80–87)


197. Ibid., p. 311 (translation).


200. Ibid., p. 25.

201. Ibid., p. 27.


203. Foro Italiano (see note 198), p. 2076 (Translation).


205. On the valuation of gold in official reserves, see Pamphlet No. 26, p. 86, n. 98; Pamphlet No. 33, p. 89; Pamphlet No. 40, p. 77.

206. Foro Italiano (see note 198), p. 2077 (Translation).

207. See note 199, pp. 23 and 25.

208. The indices as published by the Instituto Centrale di Statistica (ISTAT) (Central Institute of Statistics), Rome.


210. Ibid., p. 195.

211. See Pamphlet No. 26, pp. 24–26; Pamphlet No. 33, pp. 32–33.

212. Schip en Schade (Zwolle, the Netherlands), No. 30 (1983), pp. 78–80.

213. See note 199, p. 259.

214. See note 212, p. 78 (Translation).


218. Ibid., Section 4(1), p. 676.

219. Under Section 5 of the statute that was brought into force by the Order cited in note 216, the value of an SDR on a particular day shall be treated as equal to such sum in sterling as the Fund has found for that day. or, if no sum has been found for that day, for the last day before that day for which the Fund has found a sum. A certificate by or on behalf of the U.K. Treasury stating the sum in sterling in accordance with the foregoing rule shall be conclusive evidence in any proceedings.
220. The report does not clarify why the proceedings were brought in the Netherlands, but it may be that the defendant was a resident of that country. Article 31(1) of the CMR (see note 199, pp. 524-35, at p. 532) provides that:

In legal proceedings arising out of carriage under this Convention, the plaintiff may bring an action in any court or tribunal of a contracting country designated by agreement between the parties and, in addition, in the courts or tribunals of a country within whose territory:

(a) the defendant is ordinarily resident, or has his principal place of business, or the branch or agency through which the contract of carriage was made, or

(b) the place where the goods were taken over by the carrier or the place designated for delivery is situated,

and in no other courts or tribunals. (Translation)

Possibly, subparagraph (a) applied because the carrier received the goods in Marseilles for delivery in England.


225. The relevant Articles of the General Civil Code of Austria are as follows:

Article 6. No other interpretation shall be attributed to a particular provision of the law than that which is apparent from the plain meaning or the language employed and from the clear intention of the legislator.

Article 7. If a case can be decided neither from the language nor from the natural sense of a law, similar situations which are determined by reference to the laws and the purpose of related provisions must be taken into consideration. Should the case still remain doubtful, then it must be decided upon the carefully collected and well-considered circumstances in accordance with the natural principles of justice. 1

Footnote 1 attached to Article 7 is as follows:

These two articles (6 and 7) are rules of interpretation which are binding upon the court. Article 6 demands principally a semantic interpretation, taking into account the intent of the legislator. Such intent is found in the deliberations of the experts who drafted the law, and, in later laws in the published reports of the "motives", the reasons for drafting the laws. The first part of Article 7 refers to the use of analogy, and the second sentence refers to the principles of "natural law" which were in vogue at the time (1811). This rule was later discarded, and the meaning is now: The judge shall decide according to such rules as he would enact if he were the legislator at the time of drafting of the Code (see Commentary by Prof. Klang). (Paul L. Baack, ed., The General Civil Code of Austria, annotated and rev. ed. (Dobbs Ferry, New York: Oceana Publications, for the Parker School of Foreign and Comparative Law, Columbia University, 1972), p. 4).
226. See brief referred to in note 221 above, at BA19.
227. Ibid.
228. Pamphlet No. 40, pp. 87–89.
229. For further support, the court cited Article 1: Definitions of International Air Transport Association, Passenger Services Conference Resolutions Manual, 3d ed. (Montreal, effective January 1, 1983).
230. See brief referred to in note 221 above, at BA23–35.
231. Article IV, Section 2(b); Schedule C, paragraph 1.
232. Article V (not IV as stated by the court), Section 12(e); Schedule B, paragraphs 3 and 7; Schedule K, paragraph 2.
234. Ibid., p. 13 (Executive Report); p. 19 (International Legal Materials).
238. See Pamphlet No. 36, p. 79.
239. Pamphlet No. 40, pp. 75–83, at p. 75.
243. Ibid., p. 45.
244. Ibid., p. 48.
245. Ibid., p. 49.
246. This statement is a broad and not completely correct paraphrase of the treatment of gold in a liquidation of the Fund. Under Schedule K, which deals with the administration of liquidation, claims on the Fund have priority in the distribution of the Fund's assets. These claims include the rights of creditors of the Fund under its borrowing agreements but not the claims of members to the repayment of any part of their subscriptions, even that part that is equivalent to the use of the subscriptions by the Fund. In the discharge of claims, the Fund uses the currency in which the claim is payable, and, if insufficient, only then gold; and finally, if these assets are inadequate, all other currencies in proportion, so far as practicable, to the quotas of members.

Even in the distribution of the rest of the Fund's assets, “creditor” members (that is, the members whose subscriptions have been used to such extent that the Fund holds their currencies in amounts less than their quotas) do not have a prior
Notes (pages 95–99)

right to the Fund’s gold that it held on August 31, 1975 and continued to hold on the date of the decision to liquidate. To the extent of the excess of the market value of this gold over the former official price, gold is distributed to those members that were members on August 31, 1975 in proportion to their quotas on that date. Only at the next step do creditor members (in the sense of the definition in parentheses above) have a prior right to gold. The Fund distributes its remaining holdings of gold among the members whose currencies are held by the Fund in amounts less than their quotas in the proportions of, but not in excess of, the amounts by which their quotas exceed the Fund’s holdings of their currencies.

247. See note 242, p. 50.
248. See Pamphlet No. 26, pp. 46–51.
251. Public Law 93–110, Section 3(b).
252. Public Law 93–373, Section 2(b).
253. For the text of the Gold Clause Joint Resolution, see Pamphlet No. 22, pp. 82–83.
254. Public Law 95–147, 91 Stat. 1227, Section 4(c).
255. 676 F.2d 643 (1982).
258. See, for example, Pamphlet No. 26, pp. 49–50, and 93, nn. 169, 170.
263. Ibid., sec. 8. See Pamphlet No. 26, pp. 40–41.
264. 646 F.2d 1185 (1981).
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