LEGAL ASPECTS OF CONVERTIBILITY

Dr. Rainer Geiger*

A. Introduction: Essence and Purpose of Convertibility

The convertibility of currencies has to be seen in close connection with the promotion of an international division of labour and the liberalization of international trade. The world economy is divided into a number of national economies which are distinguished by their different resources, skills and conditions of production. In the absence of a universally accepted monetary unit for payment, each country must have its own currency and monetary system. The functional value of money, therefore, is originally limited by national borders. If there is no possibility of conversion a specific currency can only be used as a means of exchange for goods and services within the territory of the issuing country.

Unless a country chooses to be completely self-sufficient it must adhere to some system of international payments. Basically it has two options: it may bilaterally or multilaterally agree on a clearing system, or it may convert against other currencies.

Bilateral payment arrangements became widespread in the post-World War II period and are still of special importance for the trade relations between western and state trading countries. Until December, 1958, when most of the non-communist European countries accepted "external convertibility" of their currencies, the European Payments Union (EPU) provided for a multilateral clearing system. A similar arrangement still exists within the COMECON. Bilateral and multilateral clearing systems constitute a mechanism by which the partner countries can effect their reciprocal current settlements with a minimum of gold or foreign exchange. In a bilateral arrangement the two central banks open accounts in their respective currencies in each other's name. All permitted payments are channeled through these accounts and the remaining balance is settled in foreign exchange from time to time. In a multilateral system all accounts are in one bank and are settled on the basis of a common unit of account.¹

The second option, convertibility of the country's currency, means the transformation of home money into foreign money by exchanging the various currencies against each other at a certain price called the ex-

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*Assistant Counsel in the Federal Ministry of Economic Cooperation, Bonn, Germany. Dr. jur. University of Heidelberg, LL.M. Columbia University.

¹The COMECON Bank now uses the transferable rouble as its unit of account.
change rate.

It is obvious that bilateral and even multilateral payment arrangements, which are essentially discriminatory, seriously hamper international trade and international integration. The inconvertibility of currencies, even in the absence of trade restrictions, is a serious obstacle to international transactions of goods and services; restrictive trade policies can make a currency practically inconvertible. In fact, currency restrictions are often combined with discriminatory trade practices, import quotas or protective tariff policies.

Two complementary efforts have been made to promote world trade and international economic integration. The General Agreements on Tariffs and Trade (GATT) seeks to achieve unrestricted multilateral trade by prohibiting import quotas and discrimination. The International Monetary Fund (IMF) has as its basic purpose the promotion of international monetary cooperation by the establishment of uniform exchange rates and a multilateral system of convertible currencies.

The establishment of free international trade and the complete elimination of currency restrictions, however, are ideals which can only be realized gradually. Liberalization may be difficult after periods of isolation, and therefore protection is necessary for periods of adaptation while restoring the equilibrium of home markets.

The draftsmen of the Articles of Agreement of the IMF were aware of these difficulties. They found an equitable and viable solution. The Articles of Agreement demand the complete elimination of currency restrictions on current transactions but permit a transitional period for those members which are not yet prepared to face the full obligations of convertibility.

What are these obligations? How can we define convertibility? At first sight the definition seems easy: exchangeability of currency. But this is too general to be satisfactory. In fact, there is a large variety of concepts of convertibility. The opinions differ even as to what should be regarded as the theoretical maximum. According to Hartung, complete convertibility means entire freedom of all trade and currency transactions. In the opinion of Joseph Gold, the concept of convertibility is related only to currency and not to trade. Therefore it should be assessed only on currency measures. Consequently Gold believes maximum convertibility to be the free use and exchangeability of a currency at its par value or at some fixed rate of exchange without any restriction of currency character.

1HARTUNG, DIE PROBLEM DER WAHRUNGSKONVERTIERBARKEIT, at 17 (1959).
The recent monetary crisis has shown that even the industrialized and prosperous western countries are still far away from this minimum standard. In some countries the stability of exchange rates had to be sacrificed in order to avoid exchange restrictions, while others adopted controls on capital transfers or established multiple currency practices with respect to current and capital transactions. Though the dollar has been inconvertible into gold since August 15, 1971, it continues to be a convertible currency for other purposes. In December, 1958, most European countries had reached external convertibility, i.e., convertibility for nonresidents, while maintaining some exchange restrictions for residents.

As we can see, there is no uniform or universally agreed concept or definition. From inconvertibility to the conceivable theoretical maximum of convertibility there is a wide range of standards. The concepts of convertibility vary with its different purposes. For this reason many international agreements and other legal instruments referring to "convertibility" avoid a general definition and provide for ad hoc determination. It is in the Articles of Agreement of the IMF that we find a number of legal standards of convertibility which are not only of particular importance in international public law but which also have a considerable impact on private business transactions.

B. Legal Aspects of Convertibility in Public International Law.

I. De jure convertibility under Art VIII of the IMF Agreement.

The definition given by Article XIX(d) describes the convertibility that each member must eventually adopt, thereby accepting the obligations enumerated in Article VIII Sections 2, 3, and 4.

This definition is significant because of its originality. In contrast with the great variety of concepts of convertibility mentioned above, Article XIX does not refer to a factual situation or certain objective elements; the only decisive criterion is the formally expressed will of a member to assume a certain legal status. We have to consider the consequences of this declaration of acceptance in order to know what convertibility, for the Fund's purposes, really means.

Article VIII is one of the most important provisions of the Articles of Agreement. It is directly related to the Fund's basic purpose of

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4 *Id.* at 58.
5 See *ARTICLES OF AGREEMENT OF THE INTERNATIONAL DEVELOPMENT ASSOCIATION (IDA)* art. 12 § 2f; *ARTICLES OF AGREEMENT OF THE ASIAN DEVELOPMENT BANK* art. 25.
promoting international monetary cooperation by a multilateral system of payments. In order to achieve this purpose, Article VIII in section 2(a) generally prohibits the imposition of restrictions on the "making of payments and transfers for current international transactions" without prior approval of the Fund. To understand this prohibition it is essential to know what the term "restrictions on current payments" really means.

Restrictions, as distinguished from controls, are only those measures which have a real interference with payments and transfers. Government limitation on, or effective hindrance of, the availability or use of foreign exchange in connection with international transactions undoubtedly must be regarded as a restriction. Article VIII section 2(a) on the other hand, does not prevent a member from using reasonable controls precedent to payments or transfers, provided that the control procedures do not unduly delay these operations. Such controls may be necessary to segregate capital transfers which under Article VI section 3 are subject to limitations and restrictions.

Article VIII does not require freedom of capital transfers because the exercise of that freedom not only produces disequilibrium in a country's economy, but may also seriously endanger the stability of the international monetary system. This was clearly demonstrated recently by the speculation against the dollar. For this reason the Fund can request a member to impose capital controls to meet "a large or sustained outflow of capital" under Article VI section 1(a). This leads us to the question of distinguishing current and capital transactions.

The definition of "current" and "capital" is grounded on economic concepts. The balance of payments generally includes in Group A exports and imports as shown in external trade statistics, and in Group B transfer payments, i.e., receipts and payments without a quid pro quo. Groups A and B together are sometimes called "the current balance". This term, however, is not used consistently from country to country. Some divide transfers in capital and current transfers without being able to indicate a clear criterion for this distinction. The IMF Agreement, while based on economic distinctions, gives a legal definition which is

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*In order to determine if there is a large or sustained outflow, the Fund may rely upon the size and duration compared with previous outflows, the size of the members economy or the size of its quota. Cf. Evans, Current and Capital Transactions: How the Fund Defines Them, 5 Finance and Development 30 (1968).


*Id. at 11.
shaped after the purpose of the Articles and is not entirely consistent with views held by economists.

According to Article XIX(i) current transactions include, without limitation:

(1) All payments due in connection with foreign trade, other current business, including services and normal short-term banking and credit facilities
(2) Payments due as interest on loans and as net income from other investments
(3) Payments of moderate amount for amortization of loans or for depreciation of direct investments
(4) Moderate remittances for family living expenses.

This definition of “current” includes all payments so defined by economic formulas. In addition it includes transfer payments for which no established rule exists and certain payments which otherwise would be considered capital from an economic standpoint. It has been adopted to attain certain policy objectives and therefore extends to all payments which in pursuance of these objectives were to be given the preferential treatment of Article VIII section 2(a).

There has been some doubt about the meaning of the term “restrictions on payments.” Every restriction, even of a trade character such as import quotas, directly or indirectly affects the freedom of payments. This doubt has been removed by Executive Decision No. 1034 of June 1, 1960. The guiding principle under this decision is whether a restriction involves a direct governmental limitation on the availability or use of exchange as such. Governmental interventions of a purely trade character are not within the jurisdiction of the Fund.

The “current account” convertibility established by Article VIII is not only an external convertibility. By prohibiting restriction on the making of payments, Article VIII imposes the duty to permit residents as well as non-residents to get the foreign exchange needed for international transactions.

The term “making of payments” means that a member may not restrict outpayments. On the contrary, it is entirely free to impose restriction on inpayments. Article VIII section 2(a) does not deal with

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10 Evans, supra, at 34-35.
11 Normal short term banking and credit facilities (Art. XIX(i)) are necessary to the sustaining of trade and current business operations. This is the reason why in spite of their capital character they are deemed current for the purpose of Art. VIII § 2 (a).
12 IMF Exec Dec 1034 (60/27) June 1, 1960 Sel. Dec. p. 82.
13 J. Gold, supra note 6, at 8-9.
the receipt of currency by residents. The member therefore may pre-
scribe which currency to receive and it may even require the surrender
of foreign exchange earnings by its residents.

In addition to the freedom of outpayments, Article VIII section 2(a)
provides for the freedom of transfer. This means that a non-resident
must be permitted to convert balances accrued from current interna-
tional transactions. These balances, however, must be presented for
conversion or settlements in other transactions within a reasonable
length of time, taking into account business practices in connection with
working balances and repatriation of profits.\textsuperscript{15} If balances are held for
a longer period, the presumption may arise that the holder wants to
make an investment. They then can be considered as capital and, in
consequence, are subject to capital controls under Article VI section 3.

Under Article VIII section 3, members are obliged to avoid discrimi-
natory currency practices and to discontinue any such existing arrange-
ments or practices. According to the Fund’s jurisdiction, this provision
includes only arrangements which are directly related to currency.\textsuperscript{16} Its
purpose is to eliminate bilateral or multilateral clearing systems which,
as mentioned above, may seriously disturb international trade. Multiple
currency practices are regulations which provide different exchange
rates for the currency of a country, depending on the nature of the
transaction involved. When used for balance of payments purposes,
multiple exchange rates have the same effect as import restrictions.
Article VIII section 3 does not explicitly refer to current transactions.
An interpretation by the Executive Directors, however, has made clear
that in accordance with Article VI section 3 members are free to intro-
duce or to maintain capital controls of discriminatory character.\textsuperscript{17} The
prohibition of discriminatory arrangements and multiple currency prac-
tices therefore is limited to current payments and transfers.

While section 2(a) of Article VIII requires freedom for parties of
international transactions, whether private or official, to conduct their
current business in the exchange markets of the members, section 4
contains rules for the conversion of balances between monetary authori-
ties of the members. Until now the procedure provided by Article VIII
section 4 has had no practical importance; the markets proved to be the
main mechanism for conversion. Article VIII section 4 means essen-
tially conversion through the Fund, because the converting member

\textsuperscript{15}\cite{Evans, supra, at 32.}
\textsuperscript{16}\cite{J. Gold, supra note 6, at 15.}
\textsuperscript{17}\cite{Exec. Dec. No. 541 (56/39) of July 25, 1956, Sel. Dec. at 55.}
\textsuperscript{18}There is only one example of an official conversion under Art. VIII § (4); see IMF Press
generally will draw on the Fund to obtain the demanded currency. For this reason there is no obligation to convert official balances if the converting country is not entitled to purchase from the Fund (Article VIII section 4 b (v)). Furthermore, conversion under section 4 is limited to balances obtained from or needed for current transactions. This is probably the reason why the provision was virtually never applied. Central banks, in intervening on the market, do not distinguish between current or capital balances. So, if the monetary authorities of the countries whose dollar holdings have been inflated as the result of last year's or a previous year's monetary crisis were to present some of their dollar balances for official conversion, the United States could object that they have not been acquired recently as a result of current transactions. The actual "dollar problem" therefore can not be resolved on the basis of Article VIII section 4.

As we have seen, concepts of convertibility defining the theoretical maximum demand not only complete freedom of payments and transfers, but also stability of exchange rates. Article VIII does not go so far. It contains no assurance of the exchange rates at which the currency may be used and converted. So even if a member no longer observes the exchange rate provisions of Article IV, its currency continues to be convertible under Article VIII. In fact, some members recently let their currencies float in order to avoid exchange controls. This had no influence on convertibility.

The members which accepted the obligations of "current account" convertibility under Article III can introduce exchange restrictions on current payments and transfers only under exceptional circumstances. If the Fund finds that its holding of a member's currency will not be sufficient to meet the demand, it can formally declare the scarcity of the currency. Under Article VII (3), after such a declaration any member is free to impose temporary restrictions on the exchange of the scarce currency. This provision, originally devised as a means of sharing the burden of balance of payments adjustments between surplus and deficit countries, has never been applied.

A member can also introduce exchange restrictions, with the prior approval of the Fund. The Fund has adopted strict policy guidelines for such approval. The acceptance of the full obligations of Article VIII is deemed to be the last and final step towards convertibility. There should

[Gold, supra note 3, at 16.]
[Id. at 17.]

[For a discussion of the efficiency of the scarce currency provision see Meier, The Bretton Woods Agreement—Twenty Five Years After, 23 STAN. L. REV. 240 (1971).]
be no retrogression. Under the Executive Decision of June 1, 1960, approval of restrictions must be based on a close scrutiny of the country's overall economic position and the possibility of alternative corrective measures, particularly in the monetary and fiscal fields.\(^2\)

The introduction of exchange restrictions, does not affect the legal status of the member's currency. Under Article VIII, the currency remains de jure convertible, even if as a consequence of substantial restrictions approved by the Fund, it is inconvertible in fact.\(^3\)

De jure convertibility of a currency only means that the issuing member has accepted the status of Article VIII, sections 2, 3, and 4. It does not necessarily mean that this currency is available for international transactions at some assured exchange rate. There may be a sharp division between the legal status and the actual situation. The concept of de jure convertibility has been primarily designed as a standard for the members' obligations of good monetary conduct, standards of behaviour do not necessarily reflect reality. There are however, other purposes and activities of the Fund which do not permit such a degree of abstraction from factual elements. For these purposes, the concept of de jure inconvertibility is insufficient; additional standards had to be developed particularly in connection with the General Arrangements to Borrow (GAB) and the establishment of the Special Drawing Rights (SDR). But let us first consider the concept of "de facto convertibility" which we can already find in the Articles of Agreement in their original form.

II. "De Facto" Convertibility

The obligations of Article VIII are binding on all members from the date that they join the Fund. But these obligations may be modified if members choose to avail themselves of the transitional arrangements of Article XIV. The post-war transitional period is not defined as to its duration. The Fund has no authority to announce generally the end of this period.\(^4\) The initiative to assume de jure convertibility under Article VIII rests with the members and the Fund can only make representations that conditions are favorable to the withdrawal of a particular restriction or to the general abandonment of all restrictions (Article XIV section 4).

The acceptance of Article VIII is irrevocable. A decision of this kind

\(^{2}\text{Supra note 12.}\)

\(^{3}\text{Gold, supra note 3, at 11.}\)

demands careful deliberation. The prudence of the members has even been encouraged by the Fund which, in its Executive Decision of June 1, 1960, declared itself particularly reluctant to approve exchange restrictions for Article VIII currencies.

It is the practice of the Fund that new members may still choose the status of Article XIV. They may then maintain or adapt existing exchange restrictions. New restrictions, however, as well as any change of multiple exchange rates, must be approved by the Fund. Actually, two-thirds of the Fund's members, nearly all of which are developing countries, avail themselves of the transitional advantages of Article XIV. Their currencies therefore are inconvertible by definition Article XIX(d), but not necessarily inconvertible in fact. So, if all existing restrictions are abandoned, a member may take no further action under Article XIV. Its currency then is "de facto convertible", although it remains de jure inconvertible until notice of acceptance of Article VIII has been given. In some cases de facto convertibility may even be broader if, for a de jure convertible currency, the Fund has approved restrictions under Article VIII section 2(a).

Some of the members' obligations such as the repurchase of the currencies from the Fund and the payment of charges and subscriptions depend on the extent and nature of their monetary reserves. Under Article XIX(g) balances of de jure inconvertible currency may be deemed convertible for the purpose of calculating monetary reserves if there is a reasonable factual basis that conversion will be available at the option of the holder of the currency. The underlying policy of Article XIX(g) is to recognize the de facto convertibility of certain currencies and to prevent members from reducing their purchase obligations under Article V section 7(b) by holding balances which are convertible de facto but not de jure. Until now Article XIX (g) has had no practical importance for the reason that all members which have an important role in international trade and strong currencies have established convertibility under Article VIII.

De facto convertibility is further recognized by Article XIX (h). According to this provision, for the purpose of calculating a member's gold

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25 Most Western European countries did not abandon all restrictions on current payments until the end of 1958 and did not accept the status of de jure convertibility until February 1961.
26 Gold, supra note 3 at 22; For multiple exchange rates see Exec. Dec No (57/33) June 26, 1957 Sel Dec. at 90.
28 ARTICLES OF AGREEMENT OF THE IMF art. V § 8 para f.
29 ARTICLE OF AGREEMENT OF THE IMF art. III § 4 para a.
30 Gold, supra note 3, at 26.
subscription under Article III section 3(b), from its official holdings of gold or United States dollars may be deducted from the de facto convertible holdings of its own currency by other countries, official institutions or banks.

III. The Concept of "Convertibility in Fact" in the General Arrangements to Borrow

In the General Arrangements to Borrow (GAB) which became effective on October 24, 1962, the ten most important western industrial countries (the Group of Ten) agreed with the Fund to stand ready to lend their currencies to the Fund when supplementary resources are needed to meet an impairment of the international monetary system. Under paragraph II (a) repayment has to be made in the participant’s currency whenever feasible, or in gold or, after consultation with the participant, in other currencies that are convertible in fact.

This concept of convertibility was adopted with respect to one participant (Japan) whose currency was at that time inconvertible under Article VIII, but convertible in the market. Another reason was to give the participants some insurance that they would be repaid in a currency meeting their needs. As we have seen, a currency which is de jure convertible may be subject to substantial exchange restrictions and, therefore, be inconvertible in fact. The Fund should not repay in a currency of such character.

In contrast to Article VIII the concept of convertibility in fact, which has not been defined by the GAB, is exclusively based on objective elements, in particular the absence of actual exchange restrictions. A currency that cannot be converted is inadequate for repayment and can be returned to the Fund. Similar to Article VIII, convertibility in fact includes no element of assured exchange value. The participants’ interests, however, are safeguarded because claims of repayment under the GAB are guaranteed as to value and will generally be discharged by the Fund at the parity or a representative market rate established at the time when the loan was made.

IV. Convertibility in Fact in the New System of Special Drawing Rights

The Special Drawing Rights (SDR), created in 1968 in order to in-
crease world liquidity by supplementing the existing reserve assets, represent the obligation of all participants of the Special Drawing Account to provide convertible currency. The value of the SDR rests on international cooperation, the readiness of virtually all non-communist countries to accept them in settlement of payment imbalances.

Under the conditions of Article XXV section 2(b) transactions with SDRs can be freely agreed upon between participants. In the majority of cases however, they are transferred by the transferor to a transferee which has been designated by the Fund. The transferee, in exchange, is not obliged to provide the currency originally wanted; it can discharge its obligation by any other currency "convertible in fact."

Like in the GAB the term "convertible in fact" has been designed to make sure that the transferor receives a currency that meets certain standards of effective convertibility which are not involved in the concept of Article VIII. As an additional element convertibility for the purpose of the SDRs includes the guarantee of "equal value." As we have seen, there is no such requirement for repayments under the GAB.

Article XXXII (b) distinguishes two categories of currencies which are regarded as convertible for the purposes of transactions with SDRs. There are four elements in the definition of the first category of currency convertible in fact: de jure convertibility, interconvertibility, equal value and official conversion.

In view of the other components, de jure convertibility is of no particular importance for our definition. It has been included primarily for the purpose of increasing the likelihood that the transferee will be holding a currency that is convertible in fact and that it will have no difficulty producing such a currency from its reserves.

It is the purpose of interconvertibility to assure that the transferor gets exactly the currency of the first category it wants even if the transferee provides another currency. The term "interconvertibility" was not incorporated in the Articles, but it was used in the Report of the Executive Directors to the Board of Governors on the proposed amendments. It means that a currency of the first category obtained in a transaction involving SDRs must be convertible into any other currency of the first category which the transferor of SDRs wants. Before deciding that a currency meets the requirements of convertibility in fact, the Fund will consult members to determine whether appropriate arrangements have been taken to assure the conversion of that currency into

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33Id. at 42.
all other currencies of the first category.\footnote{The Int'l. Monetary Fund, By-Laws, Rules and Regulations, 28th Issue, Oct. 20, 1969, Rule 0-1.}

If the transferee provides a currency other than that wanted, the transferor has to be assured that the issuer will convert it at a rate of exchange yielding the same amount of that currency; for instance, should the transferor demand dollars and the transferee provide French francs, France will convert these balances into dollars. At the moment of the conversion, however, the exchange rate of the franc may be a discount on the market within the margins of par or, if fluctuating rates have been adopted, outside of these margins. In this case the transferor would not get the same amount of dollars he would have received if the transferee had provided dollars in the first place.

In order to avoid such differences of treatment and to prevent a transferee from deliberately providing a currency that is at discount in the market, the requirement of "equal value" has been included in the definition of convertibility in fact.\footnote{Gold, supra note 3, at 48.} Article XXV section 8(a) provides that:

The exchange rates for operations or transactions between participants shall be such that a participant using SDRs shall receive the same value, whatever currencies might be provided and whichever participants provide those currencies, and the Fund shall adopt regulations to give effect to this principle.

This provision has been made effective by rule 0-3 of the Fund’s Rules and Regulations. Under this rule, the exchange rates applicable to transactions involving SDRs are: par value for the U.S. dollar and for other currencies the representative rate for spot delivery of the dollar. Where such a rate can not be easily ascertained, a cross-rate will be calculated on the basis of representative rates. The requirement of "equal value" guarantees that the rate for conversion into the currency wanted will be the rate prevailing at the date of the dispatch of the Fund's instruction designating a transferee, or where no designation is involved, the date on which the transferor gives notice to the Fund before the transaction is carried out.\footnote{The Int'l. Monetary Fund, By-Laws, Rules and Regulations, supra Rule 0-4.}

The fourth element of the definition, official conversion, does not necessarily mean that conversion must take place directly between the monetary authorities of the countries involved in the transaction. Its only purpose is to give effect to the requirement of "equal value." Official conversion means that, even if the issue conducts the conversion
through the market, it remains responsible for seeing that equal value is provided. Therefore, if the rate of its currency is at a discount on the day of the conversion compared with the day of the dispatch of the notification or the designation instruction (Rule 0-4) the issuer must bear the loss.

Under Article XXXII (b) (2) currencies convertible in fact of the second category must fulfill two conditions. First, in the opinion of the Fund, satisfactory arrangements must exist for conversion by the issuer into at least one currency of the first category. Interconvertibility is not required. Second, the conversion must satisfy the "equal value" requirement under the rules described above.

So far currencies of the first category are the U.S. dollar, the British pound sterling and the French franc. The currencies of Belgium, Germany, Italy, Netherlands and Mexico have been established as currencies of the second category. Each of these participants has arranged that any conversion of its currency will be into U.S. dollars but not into the other two interconvertible currencies.

V. The concept of gold convertibility

In the text of the Fund's Articles of Agreement, gold plays only a marginal role. Under the convertibility provision of Article VIII the members are not committed to gold. In reality, however, until the creation of the SDRs as a supplementary reserve asset, gold has been one of the pivotal factors of the international monetary system. This is why President Nixon's decision of August 15, 1971, to suspend the gold convertibility of the dollar so seriously threatened the stability of the whole system and so dramatically emphasized the necessity of reforms. Before we consider the meaning of this decision, let us define the essence and purpose of gold convertibility.

Under Article IV section 4 (b) exchange transactions must take place only within certain defined margins from par. Without intervening on the exchange market a member may fulfill its obligation to parity by freely buying or selling gold. The gold convertibility of Article IV section 4(b) includes two elements. First, a member must stand ready to buy and to sell gold at prices based on the par value of its currency. Under this condition the other members can obtain for gold the intervention currency they need in order to maintain appropriate margins. Second, a member must not maintain any restrictions on payments for current transactions as well as capital transfers. Gold convertibility

40These margins have been considerably widened by the realignment decision of Dec. 18, 1971. See INT'L FINANCIAL NEWS SURVEY Vol XXIII No. 50, p. 419 Dec 22-30, 1971.
therefore is more rigorous than the "current account" convertibility of Article VIII.11

Until August 15, 1971, the role of the dollar as the main reserve currency was based on the U.S. commitment to gold.42 Relying on this commitment the other countries helped to finance a long string of U.S. deficits by increasing their dollar holdings. As a consequence, the U.S. did not need to intervene on the exchange markets in order to support its currency.

Undoubtedly the Executive Decision of August 15 was consistent with domestic as well as international law. The Gold Reserve Act of 193413 gives the President the power to revoke the commitment to convert dollars into gold. Under the IMF Agreement members are not legally bound to sell or buy gold freely and can decide at any time to terminate this practice.44

The present status of dollar inconvertibility is highly unsatisfactory. The absence of a provision for the settlement of dollar balances unduly shields the United States from the working of the adjustment process; its deficit being permanently financed by the accumulation of its inconvertible currency abroad.45 The uncontrolled extension of U.S. dollar liabilities has proved to be a major cause for world-wide inflation.46

VI. Convertibility and the Settlement of Imbalances in a Reformed Monetary System

In order to control liquidity a reformed international monetary system has to provide for the settlement of payments imbalances by means of primary reserve assets or negotiated credit facilities.47 Two alternatives have been suggested.

The first approach, sponsored mainly by the West European countries, may be characterized as mandatory convertibility. It means that countries whose currencies are held in official reserves have to sell primary reserve assets (mainly SDRs) in exchange for their own currency to the extent of the increase in aggregate foreign holdings of that currency. In case of a decrease, they would be entitled to buy SDRs from a substitution facility to be established in the Fund in exchange for their

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11Gold, supra note 3, at 36.
1220 FED. RES. BUL. 69 (1934).
14Gold, supra note 3, at 36.
15See Meier, supra note 21, at 235-261.
16In the last three years monetary reserves have almost doubled from 75 to 145 billion SDR.
17See Reform of the International Monetary System, A Report by the Executive Directors to the Board of Governors, Chapter III (1972).
own currency.

The other alternative, suggested by the United States, allows for optional asset settlement of imbalances. The reserve center would have to convert foreign official holdings of its currency only if so requested by the creditor country. Consequently every member country would remain free to continue the holding of dollars in its official reserves without limitation.

During the meeting of the Committee of the Twenty on July 30/31 1973 European and American differences on the issue of convertibility were considerably narrowed. A possible compromise would be the combination of strict asset settlement among the major countries, which would participate in a scheme of multicurrency intervention with a less stringent convertibility system with regard to third countries.

C. Legal Aspects of Convertibility in Private International Law

Unlike most other provisions of the Fund's Article of Agreement, the standards of convertibility in Article VIII have an immediate effect on private business transactions and private international law.

I. The unenforceability of exchange contracts under Article VIII 2 (b)

As we have seen, members which have accepted the obligations of de jure convertibility may, in exceptional circumstances and with the Fund's prior approval, maintain or introduce restrictions on current payments and transfers. In order to give effect to these restrictions, Article VIII section 2 (b) provides as follows:

Exchange contract which involve the currency of any member and which are contrary to the exchange control regulations of that member maintained or imposed consistently with this Agreement shall be unenforceable in the territories of any member . . . .

This provision is consistent with the Fund's standards of convertibility. In point of fact the obligation of Article VIII, section 2 (b) is closely related to the basic purpose of the Fund "to promote international monetary cooperation" (Article I, section (i), and to the realization that exchange restrictions on capital movements may sometimes be necessary. Therefore, measures to give effect to each other's exchange control regulations contribute to the objectives of the Agreement.


Article VIII section 2 (b) has been applied and interpreted in a large number of judicial decisions in several countries and is the subject of an abundant literature. In the scope of the present study we can only give a summary of the main issues. For this purpose we shall rely on a recent decision of the German Supreme Federal Court (BGH) which illustrates these issues particularly well. In July and August 1963 the plaintiff, a West German company, in performance of a contract concluded in East Berlin delivered to the defendant, a French firm, halves of pork produced in East Germany, at the price of more than 1/4 million U.S. dollars. Under the French exchange regulations, applicable at that time, the price for goods from East Germany was not permitted to be paid directly to a West German vendor but had to be transferred within a clearing system to a “bilateral Francs” account with an East German bank. Therefore, after a dollar transfer to the plaintiff and defendant’s bank was fined. At that time defendant still owed plaintiff a balance of 250,000 dollars. In order to find a solution the parties met in Geneva in September 1963. There they agreed on the transfer of the remaining balance in “bilateral Francs” and defendant undertook to bear any loss on the exchange rate. According to the agreement of the parties the x value of the “bilateral Francs” was to be realized by means of a “switch transaction” which resulted in a 7% loss on the exchange rate amounting to about 60,000 DM. Plaintiff filed suit against defendant in the District Court (Landgericht) of Frankfurt, Germany for recovery of this amount. Defendant objected that the agreement concluded in Geneva was void because it violated French exchange regulations. At the time of the action, however, the French regulations which were applicable in 1963 had been repealed.

The District Court entered judgment for the plaintiff, the Court of Appeals affirmed and the BGH dismissed the appeal. The present case involves some important issues as to the interpretation of Article VIII 2 (b). The first question is whether the transaction can be regarded as an “exchange contract.”

There are three possible approaches to this problem. Arthur Nussbaum has suggested a restrictive interpretation. In his view “exchange contracts” are only concerned with the handling of international media


The parties had agreed on the applicability of German law and the jurisdiction of the District Court of Frankfurt, Germany.

A. Nussbaum, Money in the Law National and International (1950) at 543.
of payment as such. This definition excludes all contracts involving securities or merchandise. It would limit the scope of Article VIII section 2 (b) to the point of rendering it almost meaningless. Another view is to define exchange contracts to include only transactions which provide for consideration in the form of foreign exchange. This would exclude the exchange of gold or securities against consideration other than currency. As Professor Mann pointed out, however, this result would be contrary to the intention of the Articles.  

A majority of authors are of the opinion that the term "exchange contract" means all contracts which in any way affect a country's exchange resources. No other interpretation would achieve the underlying policy of the Articles to prevent prejudicial effects to a member's reserve position.

The BGH in its decision did not explicitly pass upon this issue. In its previous decisions, however, it had already adopted the interpretation outlined under the discussion of the third approach.

Whether or not an exchange contract adversely affects a country's reserve position is an economic question and must be decided on the basis of balance of payments considerations. Undoubtedly, the agreement of the parties in the above case is an exchange contract in the sense of the governing legal interpretation. At the time of its conclusion it violated French exchange control regulations. Thus, the BGH had to pass upon the meaning of unenforceability under Article VIII section 2 (b).

By accepting the Fund's Articles of Agreement as part of their national law, the members have undertaken to give effect to the exchange control regulations of other members which are maintained or introduced consistent with the Agreement. A member's courts may not refuse to apply these regulations as being contrary to the public policy of the forum. Moreover, contracts violating such regulations must be regarded as unenforceable even if under the private international law of the forum the law under which the regulation applies is not the law which governs the contract or its performance.

As the BGH pointed out in its opinion, contracts which are unenforceable under Article VIII section 2 (b) are not void. Unenforceability means only that the courts will not implement such contracts, i.e., by decreeing performance or awarding damages.

\footnote{F. Mann, supra note 51, at 381.}

\footnote{See Id. at 381-382; T. Kern, supra note 51, at 60.}

\footnote{See Judgment of Apr. 9, 1962, 21 WM 601 (Wertpapiermitteilungen); Judgment of Mar. 11, 1970, — JZ 727 (Juristenzeitung).}
In our case, at the time of the lawsuit the exchange regulations existing at the time of the conclusion of the contract had been repealed. The BGH saw no reason why it shouldn’t enforce the contract. As we have already mentioned, the purpose of Article VIII section 2 (b) is to protect a member’s monetary reserves. In repealing its exchange control regulations the member itself declares that no further protection is needed. In the opinion of the BGH the time of performance, not the time of the conclusion of the contract, is decisive for the determination of whether the contract is unenforceable. This interpretation is consistent with the objectives of the Articles and should be approved.

II. Influence of the IMF Agreement on public policy

On the basis of extensive interpretation of the IMF Agreement some courts have come to the conclusion that, even outside of the scope of Article VIII section 2 (b), they could not refuse the application of the exchange control regulations of another member by reason of public policy if the law of the latter governed the transaction under the private international law of the forum.

In Perutz v. Bohemian Discount Bank in Liquidation the exchange regulations of Czechoslovakia were involved. In applying these regulations the New York court based its decision not on Article VIII section 2 (b), but on the membership of the U.S. and Czechoslovakia in the Fund. In Kolovrat v. Oregon, the United States Supreme Court went even further. In the latter case there was no contract and thus Article VIII was inapplicable. The Supreme Court stated in its opinion however, that the adherence of the U.S. to the Fund Agreement had created a national public policy which could not be set aside by policy considerations of state laws. On the other hand, the New York Court of Appeals refused to enforce Brasilian exchange regulations by awarding damages for their violation on the basis of a tort action; the U.S. Supreme Court denied a petition for certiorari.

The Fund Agreement cannot be so broadly construed as to require the general and unlimited application of exchange regulations of other

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9T. Kern, supra note 51, at 60.
9Id. at 73.
9In 1952 when the case was decided Czechoslovakia was still a member of the Fund.
members if the specific conditions of Article VIII section 2 (b) are not satisfied. It may, however, strongly influence public policy considerations of national courts and, as demonstrated by the U.S. Supreme Court's decision in *Kolovrat v. Oregon*, even be regarded as generating national public policy.

D. Conclusion

At present, the international monetary system is in a period of transition. At the end of this process many of its features may be substantially different from the original system as conceived at Bretton Woods, but basic obligation to maintain or establish convertibility will remain unchanged. Whatever the monetary developments or crises of the future may be, the standards of *de jure* convertibility under Article VIII belong to the essentials of international monetary cooperation. Without denial of the whole system they cannot be abandoned or even substantially minimized.

New objectives and evolutions in international law and integration may, however, create additional and even stricter concepts of convertibility. In the case of the European Common Market or other economic communities, new standards of convertibility will be developed in the course of transition from mere economic integration to a monetary union.

The SDRs which generated the ingenious concept of convertibility in fact will have a central role in the reform of the international monetary system. Originally conceived to increase world liquidity through a rational decision making process, they may replace reserve assets presently in use.

After President Nixon's decision of August 15, 1971, gold convertibility is definitely doomed. In the future it is unlikely that any country will commit itself to gold. An inconvertible dollar, however, is unacceptable as a reserve currency.

In the discussions of the reform of the international monetary system a new concept of convertibility is emerging: the settlement of imbalances by means of a primary reserve assets (SDR's & reserve positions in the Fund), or negotiated credit facilities. An agreement on this concept would be a major step toward new stability in international monetary relations and, at the same time, contribute to an adequate and viable solution of the dollar problem.


\(^{7}\)Id. at 214.