

**USE OF A FOREIGN CURRENCY UNDER THE
FUND'S ARTICLES OF AGREEMENT**

by

**François Gianviti
General Counsel
International Monetary Fund**

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In the legal framework of the Fund's Articles of Agreement, a number of provisions setting out the rights and obligations attached to membership imply that each member will have its own currency (I). However, in practice, countries have been able to accede to membership in the Fund, to exercise their rights and to perform their obligations while using another member's currency (II). Whether the issuer of that currency can object to the use of its currency by another country in its relations with the Fund or as legal tender raises questions of international law (III).

I

In 1944, when the Articles of Agreement of the International Monetary Fund were adopted at the Bretton Woods Conference, all the countries represented at the Conference had national currencies. Some even had several currencies, one for their metropolitan territories, others for their dependent territories. The possibility for a country to have different currencies for different territories was acknowledged in the Articles of Agreement¹

¹ Article IV, Section 9 of the original Articles; Article IV, Section 5 of the present Articles.

In three of the countries represented at the Conference (Liberia, Dominican Republic, and Panama), the main currency in circulation was the U.S. dollar; in two of them (Liberia and Panama), the U.S. dollar was even legal tender. However, those three countries also issued coins that were legal tender and were regarded as national currencies.

Whether a country that did not have a national currency could be admitted to membership in the Fund was not discussed at the Conference, probably because the idea that a country could decide not to exercise its regal power—with the attendant benefits (seigniorage)—of issuing its own currency seemed rather unrealistic. The assumption was that each country would have at least one national currency, and several provisions of the Fund's original and present Articles of Agreement are based on a distinction between a member's currency and the currencies of other members. In those provisions, both rights and obligations of each member are formulated in terms either of its own currency or of the relationship between its currency and other member's currencies:

(i) When a country is admitted to membership, it is assigned a quota. The member's subscription is equal to its quota and must be paid in full. One part is paid in the member's currency (75 percent) and the balance in reserve assets (gold under the original Articles; special drawing rights and/or currencies of other members as specified by the Fund, under the present Articles).² The same rules apply when a member's quota is increased.³

² Article III, Section 3 of the original Articles; Article II, Section 2, second sentence, of the present Articles. The reserve assets portion under the original Articles could not exceed

(continued)

(ii) Under the par value system, each member had to maintain exchange rates based on the parity between its currency and the currencies of other members.⁴ After the de facto end of the par value system in the early 1970s, the Second Amendment of the Fund's Articles, which became effective in 1978, allowed each member to choose between fixed and floating exchange rates.⁵ Therefore, a member may choose to maintain the value of its currency in terms of another currency or a basket of currencies ("pegging"). It may also decide to maintain the value of its currency in terms of the special drawing rights or another denominator (other than gold). Those exchange arrangements have to be notified to the Fund.⁶

(iii) In the General Resources Account, the Fund holds the currencies, gold and special drawing rights corresponding to its members' quota subscriptions. These currencies and special drawing rights can be used by the Fund to provide financial assistance to its members facing a balance of payments problem; the gold can be sold and the proceeds used for the same purpose, except that the capital gains on those sales have been used

either 25 percent in gold or ten percent of the country's net holdings of gold and U.S. dollars; in the latter case the currency portion was increased to make up the difference.

³ Article III, Section 4(a) of the original Articles; Article III, Section 3(a) of the present Articles.

⁴ Article IV, Section 3 of the original Articles.

⁵ Article IV, Section 2(b) of the present Articles. All future references are to be present Articles.

⁶ Article IV, Section 2(a).

outside the General Resources Account for financial assistance to developing countries. The Fund's financial assistance from the General Resources Account does not take the form of loans but rather of reversible sales of foreign exchange or special drawing rights in exchange for an equivalent amount of the purchasing member's currency.⁷ These transactions are similar to the currency swaps between two central banks. Like swaps they must be reversed within a specified period; this period is determined by the policies of the Fund applicable to the facility under which the purchase was made. The repurchase consists in a payment of special drawing rights or other members' currencies, as specified by the Fund, in exchange for a return of an equivalent amount of its currency to the member.⁸

(iv) While the Fund holds a member's currency, whether as a result of a subscription payment, purchase or otherwise, in the General Resources Account, the member must maintain the value of these holdings in terms of the special drawing rights.⁹ If the currency depreciates, additional payments to the Fund must be made.

(v) The Fund's holdings of a member's currency are not physical assets (notes and coins). They are balances held with a depository,¹⁰ or promissory notes issued by

⁷ Article V, Section 2(a).

⁸ Article V, Section 7(c) and (d).

⁹ Article V, Section 11.

¹⁰ Article XIII, Section 2(a).

the member or its depository.¹¹ The depository is the member's central bank; if the member has no central bank, the depository is another institution designated by the member and acceptable to the Fund.

(vi) The Fund may replenish its holdings of a member's currency by borrowing that currency from the member. The Fund may also borrow that currency from another source. In both cases, the member's consent is required.

II

Because of the importance attached by the Fund's Articles to the distinction between a member's currency and the currencies of other members, a clarification of how that distinction should be made could have been expected. It must have been thought by the drafters of the Articles that the distinction was self-evident because they did not attempt to define a criterion. Given the context in 1944, the most probable assumption was that a member's currency was understood as being issued by the member itself or by an entity (central bank) governed by the laws of the members. This definition would imply that monetary sovereignty was seen as a condition of membership, since a country cannot be admitted to membership if it is not able to perform its obligations under the Articles.

¹¹ Article III, Section 4. The promissory note "or similar obligation" is non-negotiable, non-interest bearing and payable at its face value on demand by crediting the account of the Fund in the member's depository (ibid).

In his book on Membership and Nonmembership in the International Monetary Fund published in 1974, the then General Counsel of the Fund, Sir Joseph Gold, states that “[a]s late as February 1956 the staff [of the Fund] had been of the opinion that the existence of a domestic currency was a criterion for membership.”¹² As he points out, however, “[a]lthough the norm for membership in the Fund was probably intended to be a country with a currency of its own that was subject to regulation by no other country, there were departures from that norm even among the countries listed in Schedule A.¹³ In addition, the Articles recognize that a member may have no central bank of its own, and this also was a characteristic of some of the countries that sent delegations to the Bretton Woods Conference.” In the same chapter of this book, Sir Joseph Gold lists a number of cases that fell outside what he called the “norm for membership.” For instance, Ghana was admitted to membership in 1957 before issuing its own currency. Botswana (1968), Lesotho (1968) and Swaziland (1969) became members while using the South African rand as their currencies. Other countries had common currencies (Syria and Lebanon, African countries within the CFA franc area or the East African Currency Board).

From an international law perspective, these two types of cases are fundamentally different. A common currency is not a foreign currency. For example, the euro is the currency of all the members of the euro area. The issuance of a common currency may be seen as a joint exercise of monetary sovereignty.

¹² *Op. cit.*, p. 92.

¹³ That is, the countries represented at the Bretton Woods Conference (footnote added).

From a practical standpoint, however, the relationship with the Fund raises similar issues: calculation and payment of separate quotas and maintenance of separate accounts either for each member of a monetary union or for the issuer as well as for the user of a currency. Thus, the Fund had to maintain separate accounts in South African rands for South Africa, Botswana, Lesotho and Swaziland until the three foreign users of rand decided to issue their own currencies. Today the Fund maintains separate accounts in euros for each member of the euro area. Similarly, the existence of a balance of payments problem and the level of access to Fund resources are assessed separately for each member country, regardless of whether it is the issuer or user of a currency or a member of a monetary union.

At this point of the analysis, it may be concluded that the Fund will regard a currency as the currency of a country either if that currency is issued by or on behalf of the country, which includes members of monetary unions, or if that currency is used by a country other than the issuer as legal tender and in its relations with the Fund.

The experience of the last ten years shows an evolution in the use of foreign currencies toward two types of situations.

The first one is purely transitional. For example, a newly independent country is not yet able to issue its own currency and uses the currency of the country from which it has seceded or separated during this transitional phase. Thus, after the dissolution of the Soviet Union, the Russian ruble was used by the former members of the Union until they issued

their own currencies. Sometimes, the newly independent country adopts a totally different currency. Thus, Bosnia-Herzegovina used the deutsche mark until August 11, 1997, when it adopted a national currency, which was pegged to the deutsche mark. In the Fund's accounts, the ruble was temporarily used as the currency of the former Soviet Republics as their currencies. Similarly, the accounts of Bosnia-Herzegovina was temporarily denominated in deutsche marks as that country's currency.

The second situation is just the opposite of what has just been described. It consists in the replacement of a national currency by a foreign currency as legal tender and in the country's relations with the Fund. For example, the U.S. dollar has been the currency of Ecuador since May 1, 2000.

The case of Argentina was different. The Argentine peso remained legal tender in parallel with, and pegged to, the U.S. dollar and was used by Argentina as its currency in its relations with the Fund. Therefore, the dollarization of the economy in Argentina was different from the Fund's standpoint from the dollarization in Ecuador.

In Kosovo and Montenegro, the adoption of the deutsche mark and later the euro was decided by the UN administration (Kosovo) or the federated republic's government (Montenegro), but neither is a member of the Fund. Nor is Liechtenstein, which has adopted the Swiss franc.

In the context of Bosnia-Herzegovina's admission to the Fund, an issue was raised concerning the adoption of the deutsche mark as legal tender. Was the consent of Germany required? The Fund staff's position was that, in the case of a country that did not issue its own currency, it was for that country to determine what it would use as its currency in its relations with the Fund; without a currency, the new member would not be able to fulfill its obligations and exercise its rights under the Fund's Articles; in any case, the Fund was not in a position to rule on disputes concerning the choice of a currency as legal tender as such issues had to be resolved between the two governments. Eventually, given Bosnia-Herzegovina's intention to use the deutsche mark only for a transitional period, the matter was settled.

III

Although the adoption of a foreign currency by a Fund member as legal tender and the designation of a foreign currency as the member's currency for its relations with the Fund are two separate issues, they are somewhat related. The underlying question is whether the issuer of a currency may prohibit the use of its currency by another country.¹⁴ In many cases the question does not even arise either because the use of a country's currency by another country is mostly beneficial to the issuer (seigniorage) or because the user's economy is too small to have a significant negative impact on the issuer's economy.

¹⁴ It is undisputed that the counterfeiting by a country of another country's currency would be a violation of international law (although there are numerous examples in times of war), but using is not counterfeiting.

Nevertheless, the issue did arise in the case of Bosnia-Herzegovina and may arise again.

In support of the issuer's right to object to the use of its currency by a foreign country, two lines of argument have been presented.

(a) The first argument is based on the duty of noninterference and the concept of tort under international law. By giving legal tender status to another country's currency, a country would unlawfully undermine the issuer's capacity to conduct its economic policies, thus interfering in the issuer's internal affairs. For instance, an outflow of currency from the issuer's territory to the foreign user's territory would reduce the money supply in the issuer's territory, which would require the issue of additional liquidity, with the risk of a sudden reflow, which may destabilize the issuer's economy. Both inflows and outflows of the issuer's currency could undermine the issuer's monetary policies.

On this argument, the following remarks may be made.

(i) The issuer of a currency may limit or even prohibit an outflow of its currency by imposing exchange controls. These controls would not restrict payments and transfers. They would only require that payments and transfers be made in foreign currencies, thus preserving the local money supply. Similarly, regulations could prevent local currency held abroad and illegally exported from being returned to be converted.

(ii) The granting of legal tender status to a foreign currency does not by itself make a major difference when that currency is already widely used in payments abroad. A meaningful protection of the issuer's economy against outflows would include a more aggressive attitude not only against the use of its currency as legal tender but also against the toleration of widespread uses of that currency in foreign countries. This attitude would have to be weighed against the benefits of earning seigniorage and maintaining an open economy.

(iii) Legal tender status applies to notes and coins, while the main source of liquidity is not notes and coins but bank balances. The constitution of large bank balances in correspondent accounts of foreign banks with banks in the issuer's territory is independent of the legal tender status of its currency in the foreign banks' countries. Bank balances can be monitored and limited by the regulators of the local banks.

(iv) Even if a foreign country's policies have a harmful effect on a country's economy, it does not follow that they constitute a violation of international law. Competition among countries is not by itself a breach of international law. The Fund's Articles of Agreement impose a duty not to compete through exchange rate depreciation¹⁵ and to cooperate against certain violations of another country's exchange controls,¹⁶ which

¹⁵ Article IV, Section 1(iii).

¹⁶ Article VIII, Section 2(b), first sentence: "Exchange contracts 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."

confirms the absence of a general obligation to protect the monetary system of either countries. F. A. Mann summarizes the state of international law on this matter as follows: “A State’s duty to protect the monetary systems of other States may arise from treaties or even from informal arrangements such as used to characterize the sterling area.... However, apart from treaties, it would at present not be possible to maintain that customary public international law imposes upon the State the general duty of affording protection to the monetary systems of the other members of the family of nations.”¹⁷

(b) The second argument is based on the concept of monetary sovereignty in international law. The issuance of a currency, as well as the determination of its value, legal tender status and uses as unit of account and medium of payment, are matters of sovereignty; they are governed by the *lex monetae*. Therefore, the argument goes, the issuer of a currency may prohibit the use of its currency as legal tender by another country, whether or not this use is harmful to the issuer’s economy. The difference with the preceding argument, which was based on tort, is that there would be a breach of international law for ignoring the issuer’s objections even if no actual harm could be established.

On this argument too a few comments may be made.

(i) Asserting that a country’s monetary sovereignty means that its *lex monetae* is binding on other countries and that, accordingly, the use of its currency by a

¹⁷ The Legal Aspect of Money, Fifth edition, 1992, p. 479.

foreign country is a violation of the issuer's monetary sovereignty is only a *petitio principii*, not a demonstration. It does not explain why one's country's *lex monetae* should trump another country's territorial sovereignty.

(ii) The recognition of a country's competence to regulate certain matters under international law does not necessarily mean that foreign countries have to abide by the laws of that country. For instance, acknowledging that countries have jurisdiction over their nationals implies that each country may apply its laws to its nationals without violating international law, but it does not entail an obligation for other countries to apply these same laws to the nationals of that country residing in their territories or appearing in their courts. It is well known that rules of conflicts of laws vary from country to country (except where treaties apply), because there is no general obligation to apply foreign laws.¹⁸ Even where the applicability of a foreign law is recognized by a court of law, it may be set aside by considerations of public policy (*ordre public*) of the forum.¹⁹

(iii) Monetary laws are public laws, which means that not only the criminal sanctions but also, in many countries, the civil sanctions of foreign monetary laws will not be

¹⁸ On the non-applicability to a contract—governed by French law but denominated in a foreign currency—of the *lex monetae* prohibiting gold clauses, see French Cour de cassation in the Messageries Maritimes case, Oct. 29, 1964, Clunet 1965, p. 637, obs. Goldman.

¹⁹ In the same case, an earlier decision of the Cour de cassation had held that, even if the *lex monetae* was also the *lex contractus*, the prohibition of gold clauses in international contracts could not be given effect by French courts by reason of *ordre public* (June 21, 1950, p. 1196, obs. Lerebours-Pigeonnière).

given effect as they embody the interests of a foreign sovereign. In some countries, a foreign monetary law will be recognized, but only on the basis of special circumstances, that is, as *lex contractus* or *lex loci solutionis* or *loi de police*. It may be noted that the Rome Convention on the law governing contractual obligations does not require the application of foreign *lois de police* (such as exchange controls) and allows the parties to a contract to select different laws for different parts of their contract. Even when a treaty provides for mandatory recognition of certain foreign public laws, its application is sometimes restricted through judicial interpretation. A typical example is the restrictive interpretation in the U.K., the U.S. and, to a certain extent, Germany of Article VIII, Section 2(b) on the recognition of foreign exchange controls.

(iv) History provides examples of foreign currencies being used as means of payment. In the U.K. and in the U.S., the courts have explicitly recognized the unfettered right of the sovereign (King or Congress) to grant legal tender status to specified foreign currencies, without requiring the consent of the issuer.²⁰

(v) The recognition as a principle of international law of a country's right to regulate the use of its currency abroad would give extraterritorial effect to the *lex monetae*, which would have two consequences. Not only could the *lex monetae* prohibit the use of the issuer's currency abroad but it could also make it mandatory. The first consequence would

²⁰ See in the U.K. the Wade case (77 Eng. Ref. 232 (1601)) and in the U.S. the Tyson v. United States case (285 F.2d 19 (1960)).

go even beyond the requirements of Article VIII, Section 2(b) and would make this provision superfluous, although, as mentioned above, its interpretation has been rather restrictive because it was seen as an exception to the nonapplication of foreign monetary laws rather than the recognition of their universal application. The second consequence has not even been considered in any actual case and is contrary to well-established rules of international law. In the exercise of its sovereignty a country may prohibit the use of a foreign currency within its territory. Similarly, through the imposition of exchange controls, countries may restrict the use of foreign currencies in international payments and transfers from and to their territories, subject only to their treaty commitments.

In conclusion, and subject to future consideration that may shed more light on these matters, there is at present no basis in international law to support either the first or second argument discussed above.