MITCHELL B. CARROLL *

Summit of International Monetary Law

Fundamental principles of international monetary law are being established in a multilateral treaty with 107 signatories to regulate the use of a new "money" known as "special drawing rights" (SDR's), which are intended to provide liquidity for expanding world commerce.[1]

That is briefly the challenging objective of recently approved amendments to the Articles of Agreement of the International Monetary Fund (called the Fund or the IMF), which was approved at the Bretton Woods Conference in 1944 and became legally effective on December 27, 1945. The amendments are to carry into effect the provisions in an "Outline of a Facility Based on Special Drawing Rights in the Fund," approved at the meeting of the Fund's Board of Governors at Rio de Janeiro in September 1967, by a resolution which instructed the Executive Directors to formulate appropriate amendments to the Articles.

Basic Provisions In IMF Agreement

After ratification, these amendments will amplify the code of legal obligations of the signatories which introduced limitations on the exercise of their sovereignty to replace the void that existed prior to their adoption.

This code creates international monetary law as a sector of public international law. In accordance therewith, the parties had, in the first

* MITCHELL B. CARROLL, Of Counsel, Cordert Brothers, New York; graduate of Johns Hopkins University (A.B.); the University of Bonn (LL.D.) and George Washington University (LL.B.); member of the American Foreign Law Association, American Society of International Law, American Branch of the International Law Association, Academie Diplomatique; Chairman of the Section of International and Comparative Law of the American Bar Assocation (1943–1945); President, International Fiscal Association (1939–present).

[1] American Journal of International Law, Vol. 62, April 1968, No. 2, Joseph Gold, General Counsel and Director of the Legal Department, International Monetary Fund.

place, to agree with the Fund on the par value of their respective currencies, and avoid restrictions on payments and transfers for current international transactions, discriminatory currency arrangements, multiple currency practices, fluctuating exchange rates, and certain transactions in gold at non-parity prices. Secondly, the Articles endowed the Fund with a pool of resources to which members might resort when they had to fulfill their obligations under the Articles. Thirdly, they created an international institution, the International Monetary Fund, to interpret the code of conduct and supervise its application, administer the resources, and serve as a center for consultation and collaboration with members on all matters related to the Articles.

The resources of the Fund comprise mainly the subscriptions of the members, each of which must pay 25% thereof in gold and the rest in its own currency. Quotas may be increased. After a member has established a par value for its currency in accordance with the Articles and paid in full its subscription, it may purchase other members' currencies in exchange for its own, for example, to meet difficulties in its balance of payments.

The Fund thus provides means to support policies consistent with its Articles. However, a member is not to prolong its use of the Fund's resources unduly, and is subject to complex rules on the repurchase of the currencies it has paid to the Fund, the repurchase to be made in gold or the convertible currencies of other members, and within three to five years. The Fund can sell whatever it holds of a member's currency to other members, and thereby reduce the member's duty to repurchase its own currency.

A member can purchase the currencies of other members from the Fund in an amount equal to 25 percent of its quota in any period of 12 months ending on the date of purchase. The amount between levels of exchange measured at 25 percent of the quota is called by the French work "tranche" (slice). The first tranche corresponds to the subscription in gold and is called the "gold tranche." The succeeding tranches are called "credit" tranches, despite the fact it is not legally correct to classify transactions with the Fund in terms of creditor-debtor relations.

In short, members contribute gold and currency to the Fund, which then owns such resources. The Fund sells currencies in return for the participant's currency and in due course the participant must buy back its own currency from the Fund. The term "credit" and "creditor" are used in practice because the economic effects of the

transactions are said to resemble in some respects those of credit operations.[2]

The "gold tranche" is now usually treated by members as an "asset" that could be ranked with their holdings of gold and reserve currencies. This is attributable primarily to the fact that the virtual certainty of its ready availability has given it wide-spread recognition as a new reserve asset. Credit tranches are distinguished from the gold tranche, with its "automatic" character, by the fact that a member which resorts to them is regarded as receiving assistance from the Fund.

SDR's and Liquidity

For a number of years, monetary experts have been striving to develop an international agreement to assure the world of sufficient liquidity by a process of deliberate and concerted action. Liquidity in this sense has been defined as meaning "reserves, either owned or readily available, that monetary authorities can use to support the stability of their own currencies."[3]

The need for deliberately creating liquidity was realized when the United States began to endeavor to reduce the deficit in its balance of payments by taking more and more drastic measures to curb the outflow of dollars. It was aggravated by the ever-increasing acquisition of gold by fabricators and private hoarders rather than by central banks.

The continued decline in the quantity of monetary gold in reserves would, it was feared, restrict international economic activity.

The Fund reviews quotas every five years and has increased them twice, with the result that the total of quotas has grown from the equivalent of $6.772 billion on December 27, 1945, to the equivalent of $20.987 billion on November 1, 1967. These increases augment the foreign exchange available to help overcome difficulties in international payments, mainly through purchases in the credit tranches.

However, experts felt that something more was needed. Over the last two years discussions and negotiations have been conducted primarily in two international bodies: the Executive Directors of the IMF, which is in continuous session, and the deputies of the Finance Ministers and Governors of Central Banks of the Group of Ten, i.e., industrial countries that are participants in the Fund's General

[2] Gold 366, 368, 369.

[3] Gold, 374.

Arrangements to Borrow (the United States, Deutsche Bundesbank, United Kingdom, France, Italy, Japan, Canada, Netherlands, Belgium, Sveriges Riksbank).

They "hammered out" the "Outline of a Facility based on Special Drawing Rights in the Fund." The Fund's Board of Governors at Rio de Janeiro in September 1967 adopted a resolution which instructed the Executive Directors to convert the Outline into a draft of amendments to the Articles and By-laws of the Fund, which was completed last March. The amendments have been submitted to the 107 members, and the United States has enacted legislation approving them.

Main Features of the Amendments

From the viewpoint of the international lawyer as well as the economist, the main feature of the amendments is that they provide for the deliberate control, whether by creation or cancellation, of international liquidity. This new regime is to replace dependence on more or less fortuitous factors, such as the amount of new gold production, whether it is used in monetary reserves, or the manufacture of jewelry, etc., or disappears in the "caches" of hoarders, or is absorbed in the deficits of reserve currency countries, or is displaced by interest-bearing treasury bills in the assets listed as reserves by central banks. Mr. Pierre-Paul Schweitzer, Managing Director of the Fund, at the meeting of Rio de Janeiro which adopted the plan, admirably described the document as follows:

> "The Outline reflects the principle that the international community should be able to control reserves, instead of reserves controlling the community. When a collective judgment is made that it is desirable to supplement existing reserves, there need be no fumbling for *ad hoc* solutions. The risk has been dispelled that for the lack of agreed international arrangements countries would find themselves driven to adopt solutions dictated not by reason but by force of circumstances."

Legal Character of SDR's

According to the general counsel of the IMF, the legal nature of SDR's is such that they will not be usable in market operations but only as between monetary authorities. The new "asset" is not a form of legal tender. The holder will use its rights to get a currency and will use this currency to discharge its obligations.

The Fund will designate a participant which is in a strong position from the viewpoint of its balance of payments or reserves. A

[4] Gold, 377.

participant's obligation to accept the asset will depend on whether the Fund has designated it as acceptor, and whether it is holding less than the maximum amount it can be required to hold. However, once the participant has been designated as acceptor of the rights, it is under a legal obligation to accept them.

Right to Use SDR's Unconditional

The primordial quality of special drawing rights is the unconditional character of the right to use them. A participant cannot be hampered in its use of special drawing rights by the charge that it is not doing what it is supposed to do. In this respect the SDR is superior to the gold tranche in which purchases are now *automatic* only *in fact*, although a proposed amendment would give purchases in this tranche a *de jure* unconditional quality. The guide line for the recipient of SDR's is that they are to be used for "balance of payments needs in the light of developments in its total reserves and not for the sole purpose of changing the composition of its reserves."[5] The currency provided in return for special drawing rights must be convertible in fact. The U.S.A. could request dollars, or the acceptor could present dollars or the currency of another country, instead of its own, as long as the currency is in fact convertible.

In principle, a participant that is designated to provide currency for SDR's under the Fund's guidance is absolutely obligated to provide it. A breach of this obligation may be punished by a suspension of the use of all SDR's by the violator, whereas in the case of a breach of any other obligation, the suspension relates only to SDR's afterwards acquired.

Nevertheless, a participant's obligation to provide currency in return for special drawing rights is limited to an amount equal to three times a participant's net cumulative allocation, although it may agree to hold more.

Reconstitution of Rights

In evolving the plan, there was much controversy over the concepts of whether the SDR's represented "credit" or "money," or whether a participant should be able to use the new asset without any obligation to restore its holdings of the asset. Unless such an obligation

[5] Gold, 381, 383.

existed, apprehension was expressed that the asset could be used to finance deficits of unnecessarily long or permanent duration, which might impose a continuous strain on the real resources of surplus countries. Proponents of this view pointed to the Fund's existing requirements to assure that the use of exchange purchased from it should not extend beyond three to five years.

A compromise solution was adopted: a participant indicated by the Fund accepts rights and gives its currency in exchange. The participant's *use* of SDR's during the immediately preceding five years is not to exceed 70 percent of the average net cumulative allocation of its rights during that period. In other words, its average holdings—as distinguished from "use" of SDR's—during a five-year period should not be less than 30 percent of the average during the same period of the participant's net cumulative allocation.

Participants are to endeavor to maintain a balanced relationship between their holdings of SDR's and other reserves.

Gold Value Guarantee of Rights—Interest

SDR's will be expressed in a unit of value equal to 0.888671 grains of gold nine-tenths fine, i.e., the weight and fineness of gold content of the United States dollar in effect on July 1, 1944. The maintenance of the gold value of SDR's is an important characteristic which gives the rights their quality as an asset. This is indeed a novel concept—giving an entry in an account a worth equal to its attributed "weight in gold."

Another feature to make them attractive is that holders of SDR's will receive interest paid in SDR's, but will similarly contribute to the cost in proportion to the net cumulative allocations to them. This makes the SDR's comparable in a sense to interest-bearing Treasury bills under the gold exchange standard, and makes them preferable to holdings in the gold tranche which pay nothing.

The General Account and the Special Drawing Account

While all present transactions and operations of the Fund are conducted through the General Account, the transactions and operations of the new facility will be carried out in a separate account, known as the Special Drawing Account. The word "account" is used to obviate confusion arising from the fact that the staff of the Fund is organized in "departments." The two accounts will have their separate and respective resources. Whereas the operations of the General

Account have been conducted with owned or borrowed resources, a participant that wishes to use its SDR's will obtain the currency directly from another participant, and not from a pool of resources contributed by participants.[6]

Procedure in Decisions

Authority is carefully distributed as between the Board of Governors, the Executive Directors, and the Managing Director in reaching decisions for the allocation or cancellation of SDR's. After consulting with interested persons, the Managing Director initiates a proposal to allocate or cancel rights, and submits it to the Executive Directors for their concurrence. Then the proposal goes to the Board of Governors for a decision by a majority of 85% of the total voting power.

In the course of the discussions, the then French Minister of Finance and Economy, Mr. Debre, insisted that the reserve currency countries, i.e., the United Kingdom and the United States, would have to balance their payments before the new plan was activated. It is clearly understood that SDR's will not be allocated to deal with the balance of payments difficulties of individual countries, although once they have been apportioned in accordance with the quotas they may be utilized for that purpose. Decisions will provide for allocations at uniform rates to all participants. Nevertheless, after accepting a compulsory minimum, a participant will be able to "opt out" of an allocation.

Mr. Schweitzer sums up the nature of Special Drawing Rights in this way: They will be essentially entries in the books of the Fund. Their use will be confined to national monetary authorities, and perhaps one or two international bodies, including the General Account of the Fund itself. Some people like to think of them as money, others as a form of credit. As Dr. Emminger, former Chairman of the Deputies of the Group of Ten, has aptly put it, they are a sort of zebra which can with equal accuracy be described as a white animal with black stripes or a black animal with white stripes. The material point is not how they are named but what can be done with them.

Their value, says Mr. Schweitzer, will derive essentially from the fact that participants will be obliged to accept them when properly transferred and to provide in exchange convertible currency or gold, up to a point where they are holding three times as many drawing rights as

[6] Gold, 390.

have been allocated to them by the Fund. The acceptance limit was set at this level in order to ensure that, on any reasonable view, the scheme would be endowed with a sufficient margin of liquidity.[7]

Evolution of International Monetary Principles

From a historical viewpoint SDR's are interesting because they reflect principles and practices that have evolved in monetary law at least since around 500 B.C. in ancient Sparta. Its money consisted of iron coins with no intrinsic worth but which derived their value as a medium of exchange because they were limited in number. An SDR, which is merely a book entry, has as such no intrinsic value, despite its gold value guarantee.

However, it is limited by the number that the Fund issues from time to time, by the member's quota, and in other ways. Nevertheless, dependence on gold is shown by the fact that the SDR's may be used by one member to obtain from another participant in the Special Drawing Account a desired amount of its currency that is pegged to the dollar, which can be exchanged for gold at $35.00 an ounce. This relates back to the introduction of the gold standard at a conference of monetary officials of the leading city-states or countries held in Genoa in 1445-1447. International commerce had been disrupted because of the Hundred Years War. The government decided to revive it by agreeing to settle balances due between merchants or the governments themselves by making payments in gold, in the form of a new gold florin.

The use of the gold standard developed over four and two-thirds centuries, but broke down in World War I because Britain did not have enough gold to pay her debts to her Allies and Dominions. British bankers got around this difficulty by obtaining approval at a second conference of Genoa in 1922, of what is known as the gold exchange standard. In order to economize in the use of gold, the conferees agreed that a country could issue interest-bearing Treasury bills redeemable in gold. They were actually considered to be better than gold because they bore interest, whereas owning gold involved storage charges.

On the theory that the holders of interest-bearing Treasury bills would not all seek at the same time to redeem them in gold at the Bank of England, Britain issued IOU's far in excess of its capacity to pay the

[7] Pierre-Paul Schweitzer, Managing Director, IMF, The New Arrangements to Supplement World Reserves and their Implications for the Developing Countries, December 5, 1967.

promised gold. The United States was not a participant in the Genoa Conference of 1922 because it had not recognized the League of Nations, but it followed the same practice and now has outstanding in the ownership of foreigners interest-bearing IOU's to the extent of some $32.467 billion, of which $14.3 billion are owed to foreign Central Banks and the balance is owed to nonresident private holders and international organizations such as the IMF. The United States gold stock rose to around $24.563 billions in December 1949 but has since declined to around $10.4 billions.

By a pure coincidence of course, the cumulation of deficits in the balance of payments that were incurred during 17 out of the last 18 years is about equal in amount to the previously mentioned total liability to foreigners. It is indeed ironic that the cumulative figure of the dollars given away in excess of our income to provide economic and military assistance to other nations should now be approximately matched by claims of foreign Central Banks and others that are more than three times the stock of gold of $10.4 billion which is to assure their redemption.

Normally, to pay off a deficit in the balance of payments a government takes measures to reduce the debits and increase the credits in its balance of payments to the point where its accounts show a surplus. It could then use the surplus gold or foreign exchange thus acquired in its trading and investment relations with other countries to pay off its deficit.

The U.S.A. has had in the last few years large deficits, the latest figure of the one incurred in 1967 being $3.57 billion. It is taking strong measures in 1968 to reduce appreciably the current deficit. Obviously as long as the war in Viet Nam continues it does not appear likely that the United States will be able to reduce its outlay overseas sufficiently to achieve equilibrium. Even if the amendments to the Bretton Woods agreement are adopted, presumably the U.S.A. and Britain would have to balance their payments before members with 85 percent of the voting power will activate them. In view of the $1.4 billion that has been recently provided to France and the $2 billion provided for Britain, the contemplated quotas of SDR's–e.g. for the U.S.A.–$250 million out of a suggested annual issue of $1 billion hardly seems adequate to take care of major situations. Would doubling or trebling the annual issues be sufficient?

Economists should be asked a basic question about SDR's. Let us suppose that the U.S.A. achieves equilibrium–which Secretary Fowler has defined as around $250 million above or below zero–and the plan

is activated, then in the following year, say 1970, let us suppose that the U.S.A. suffers a deficit of $500 million. If the Fund issues only $1 billion of SDR's a year, the U.S. allotment of 25% will be only $250 million. The Treasury can ask the Fund to designate one or more countries to sell to the U.S. its currency to that extent. A country designated by the Fund will be committed by the amendments to provide its own currency, or the currency of another country—even dollars, or gold equivalent to that amount. The SDR's will in this case provide exchange that will only go "half-way round," but the U.S.A. could, it would seem, draw on its "gold tranche" in the Fund for the balance. This sounds very simple and presupposes that the country designated has the currency available to meet the demand of the U.S.A. What happens if it does not have that much money available? Presumably if the receiving country has a sufficient amount of another foreign currency in its monetary reserves, it could deliver that instead.

SDR's merely call for payments out of the existing money supply in the designated country and not for the printing of new money.

Bird's Eye View of the Operation of SDRs

In order to visualize the operation of the scheme, one could imagine the managing director of the Fund sitting on a summit looking over the hills and valleys of the economic situations of the 107 member countries in all parts of the world, and watching the countless transactions between their respective nationals—buying and selling, rendering all kinds of services, investing, lending, licensing, et cetera, and the consequent crisscrossing of payments of all kinds. He has at hand the rules prescribed in the code provided in the Amended Articles of the Bretton Woods Agreement.

At any given moment, some countries are receiving more than they pay out, others are paying out more than they receive, and still others have a relative balance of debits and credits. All 107 members are to receive their fixed quotas of SDR's, but it appears that they are to be used mainly when a country has a deficit in its balance of payments. The deficits in certain countries are in theory, if not actually, offset by surpluses in others. More specifically, the U.S. deficit is offset by surpluses in Germany, Italy, and other countries.

Hence, the U.S.A. and all the other members of the Fund which have deficits can ask the managing director of the fund to designate a country or countries to which they can present their SDR's in exchange for currencies. These countries are bound to give their currencies up to

the limits fixed by the code—apparently up to three times the quota unless the central bank is disposed to give more.

The Managing Director is to guide the U.S.A. and the other deficit countries to those which have a strong balance of payments position—which presumably means a surplus—and more than it needs of monetary reserves. The designated acceptor is obligated to meet the request and provide its own currency, or the currency of a third country or gold. Perhaps the strongest foreign country today is Germany. Prior to the events of last June, France was in a very strong position but since then it has had to be supplied with $1.4 billion. Italy is fairly strong today but has recently climbed out of a recession. How many countries are there which might feel disposed to turn over most of their surplus to finance the deficit of the United States or any other member of the IMF? Certainly they may want to keep part of their surplus in the balance of payments or reserves as a hedge against adversity such as was suffered recently by France. How much of their surplus may have already been committed to a country in trouble, such as France or to Britain, and how much more will be needed by the latter before it really overcomes its deficit or can make the basic economic adjustments necessary to stand on its own feet?

Then too can each of these countries provide out of its existing supply of currency the amounts needed to meet the demands of the deficit countries? If they meet this year's demands, and the deficits are not cured, will they have enough next year to meet additional demands out of the new SDR's that will be issued.

In short, if $1 billion in SDR's is issued in 1969, they will be distributed to surplus as well as to deficit countries, but presumably they would be used only by the latter. If the issue is $1 billion, those used might equal $500 million, and the surplus countries to which they were presented, would suffer a reduction by that much in their currencies which the deficit country might use in third countries.

Theoretically if not actually, if the measures taken by the U.S.A. to reduce its deficit are successful, it will mean a corresponding reduction in the surpluses of other countries. As these surpluses gradually disappear where will the Managing Director find countries to designate as the acceptor of SDR's?

Let us suppose that the War in Viet Nam ends, and the present U.S.A. measures to reduce debits and increase credits succeed and produce a surplus. Then presumably foreign governments that have a deficit can ask the managing director to designate the U.S.A. as the acceptor and our Treasury will have to resume paying out dollars—this

time to finance the deficits of other governments under the guidance of the Fund!

Let us suppose that the scheme has gone into effect and the U.S.A. has used the allotted SDR's. Then comes the day when the U.S. Treasury is supposed to pay back the currencies it has bought–and reconstitute its holdings of SDR's. Does the payment of this debt have priority over fulfilling its obligation to meet the demands of holders of new issues of SDR's. Reciprocally, the U.S.A. will be entitled to repayment of the dollars it has supplied in exchange for SDR's.

SDRs–Economic Aspects

Briefly, SDR's do not add anything new in the nature of a tangible asset, but are merely a book entry in terms of a unit with an attributed gold value. The owner can ask another participant in the Fund to exchange them for gold. In this respect they may be likened to the IOU's under the gold exchange standard. A foreigner Central Bank could exchange them for U.S. gold at $35 an ounce. The new scheme appears essentially to broaden the practice under the gold exchange standard, with the innovation that the participant who is designated by the Fund to accept them is obligated to deliver the equivalent amount in its currency, or gold, or dollars or another currency.

Are SDRs Conducive to Inflation?

A challenging question for the economist is whether the use of SDR's may have an increasingly inflationary effect. Mr. Jacques Rueff, of France, has pointed out that the introduction of the gold exchange standard in 1922, meant that Britain, the U.S.A. and others which adopted it could issue interest-bearing IOU's redeemable in gold in payment of international debts, i.e.. without suffering any reduction in the gold backing for their currency. Taking it for granted that all their creditors would not seek redemption at the same time, they indebted themselves far in excess of their stock of gold. The amount of gold in the debtor country's reserves thus did double duty: the inclusion of these IOU's in the monetary reserves of the creditor countries, and of the gold which backed them in the monetary reserves of the debtor country, together conduced to disastrous inflation in the 1920's.

Basically SDR's are to supplement existing monetary reserves in gold and foreign exchange which is partially backed by gold. The total

stock of monetary gold is frozen at $40 billion, in accordance with a recent agreement between Central Banks, but they can sell gold to each other at the long-established price of $35.00 an ounce. The world total of monetary reserves now reaches some $70 billion, made up of the $40 billion of gold, $15 billion of dollars, $6 billion of Sterling, $6 billion of reserve positions in the IMF, and $2 billion miscellaneous. SDR's are to be issued at the rate decided by the Governors of the IMF, which is expected to be $1 or $2 billion a year. These are to be included in reserve assets. However, SDR's are merely a call on a nation's existing supply of currency which is carried out by allocating the amount exchanged for SDR's from domestic use to international use. They make the gold that backs the money go farther.

Under the existing gold exchange standard there is no limit to the volume of IOU's that may be issued by Britain, the U.S.A. or other countries except the willingness of the creditor to accept them. In contrast, the quantum of SDR's issued each year is limited by the Board of Governor's of the IMF. The quota allotted each government constitues a further limitation. In order to assure more liquidity each member, subject to certain conditions, is apparently authorized to accept up to three times the amount of its quota, or even more, of the SDR's of other governments. The recipient of the exchange may never have to pay it all back if certain conditions are met.

Inflation was caused in the 1920's by making gold go twice as far under the gold exchange standard as it had done under the gold standard. An economist with a computer might figure out the inflationary effect of a country's accepting more than three times its quota of SDR's, and of the increasing number of issues during the coming years of rights to call for currencies backed presently by some $40 billion of gold and $30 billion of other assets. This effect may be enhanced by the fact that SDR's can be transferred as freely as money from one Central Bank to another in settlement of international debts.