EFFECTS OF VARIABLE EXCHANGE RATES ON TREATIES

by

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INTRODUCTION

The par value system that was the central feature of the original Articles of Agreement of the International Monetary Fund (« Fund » or « IMF ») provided a measure of assurance about exchange rates on which countries could rely when drafting the financial provisions of treaties. The par value system broke down and has not been resuscitated by the Second Amendment of the Fund's Articles, which took effect on April 1, 1978. Instead, member countries of the Fund (« members ») are entitled to select their exchange arrangements and to determine the external value of their currencies. The assurance provided by the original Articles has disappeared. This development has created problems for countries when drafting the financial provisions of new treaties or revising these provisions in existing treaties. This article examines some problems caused by the consequences of the disappearance of the par value system and some of the responses to this phenomenon in the field of treaties. Prominent among these consequences is the variability of exchange rates or at least the concern that there is now no effective legal substitute for the former safeguard against variability.

THE FORMER PAR VALUE SYSTEM

Under the original Articles, each member of the Fund was expected to establish an initial par value for its currency in agreement with the Fund. A par value was defined directly in terms of gold or indirectly through the medium of the U.S. dollar of the weight and fineness of gold in effect on July 1, 1944. Gold, therefore, was the common denominator of the par value system. A member could propose a change in the par value of its currency in

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order to correct a fundamental disequilibrium. The effect of this criterion was that changes were not justified if a member's problem was transitory. Moreover, the requirement that a proposed change had to be one that would correct a fundamental disequilibrium meant that the change had to be neither excessive nor inadequate. A purpose of this requirement was to avoid the unsettling effects of a series of changes and the expectations that would precede them. A member wishing to change the par value of its currency had to consult the Fund in all cases, and obtain its concurrence in most cases. In contrast to present conditions, changes in par values tended to be infrequent and sizable.

An effect of the establishment of par values for all currencies was that fixed relationships would be created for all possible pairs of currencies. The ratio between any pair was called the parity. Each member was required to adopt appropriate measures to ensure that exchange rates in all exchange transactions in its territories between its currency and the currency of another member did not deviate from the parity by more than limits that were consistent with the Articles. A member could choose its appropriate measures, provided only that they were compatible with the Articles. One measure deemed appropriate was a member's willingness to buy and sell gold for its currency with the monetary authorities of other members at a price based on the par value of the currency. The United States was the only member that undertook to follow this practice for its currency. The par value system developed into one in which the United States performed this function while many other members observed their obligations by intervening in exchange markets with U.S. dollars, or with a currency convertible into U.S. dollars, in exchange for their own currencies at rates of exchange consistent with the Articles (1).

The system provided for only one kind of exchange arrangement, a single denominator for expressing the external value of currencies, endorsement of those values by the central monetary authority, and narrow margins for the fluctuation of exchange rates. These characteristics gave the negotiators of treaties the confidence that they could rely on par values in formulating financial provisions. If they found it necessary to deal with the external value of currencies, they could refer directly to par values or indirectly by adopting a unit of account defined in terms of gold. The unit of account might be the Poincaré franc, (2) the Germinal franc, (3) the U.S. dollar of the weight and fineness as of a specified date, or some other quantity of gold. The unit of

(1) For a detailed discussion, see « Legal Structure of Par Value System Before Second Amendment » in Joseph Gold, *Legal and Institutional Aspects of the International Monetary System : Selected Essays* (Washington, 1979), pp. 520-94.

(2) The Poincaré franc was established by the law of June 25, 1928 under the Poincaré Government of France, with a content of 65.5 milligrams of gold, nine-tenths fine.

(3) The Germinal franc was established after the French Revolution by the law of March 28, 1803 (7 Germinal of year XI of the revolutionary calendar) with a gold content of 10/31 gram, nine-tenths fine.

account was often the legal tender U.S. dollar, chosen with the confidence, which ultimately proved to be unfounded, that the central role of the dollar in the international monetary system made it unlikely that the currency would be devalued or revalued. By adopting one of these units of account, negotiators satisfied such aims as reasonable stability in the equivalent of the unit of account in terms of any currency of payment, international scrutiny of changes in the external value of currencies, and uniformity among currencies of payment. One effect was the discouragement of « forum shopping ». The operation of the par value system produced even more stability than was desirable for the international monetary system. A maxim often used to encapsulate the par value system was « stability without rigidity », but in time rigidity prevailed, and, according to some commentators, contributed to the collapse of the system.

Collapse it did when the President of the United States announced on August 15, 1971 that the United States would engage no longer in the purchase and sale of gold for U.S. dollars with other monetary authorities and would not adopt other appropriate measures to ensure that exchange transactions involving the U.S. dollar were confined to predetermined margins. As a consequence, exchange rates for currencies fluctuated without the imposition of discipline by a central authority or the uniformity of a common denominator. An effort was made by the Smithsonian agreement of December 18, 1971 and by the Fund's decision on central rates and wider margins of the same date (4) to create a temporary and more flexible structure on the basis of a realignment of exchange relationships. The objective was a degree of orderliness even though conformity with the Fund's Articles could not be achieved without amendment.

In March 1973, the temporary structure that was to last until the Articles could be amended collapsed in its turn. The structure could not withstand the impact of speculative movements of funds notwithstanding two devaluations of the U.S. dollar. On March 12, 1973, the Council of Finance Ministers of the European Community announced their modified agreement on common margins for exchange transactions (« the snake »). Under this agreement, some members of the Community and other countries would maintain narrow margins for exchange transactions involving their own currencies but would not maintain margins for transactions involving their currencies and the U.S. dollar. (5) Other members of the Community would allow their currencies to float without any agreement that would constrain fluctuation.

REFORM AND AMENDMENT

On July 26, 1972 the Board of Governors of the Fund adopted a resolution by which it established a Committee on Reform of the International

(4) *Selected Decisions of the International Monetary Fund and Selected Documents,* 8th Issue (Washington, D.C., 1976), pp. 14-17.

(5) Richard W. Edwards, Jr., « The European Exchange Rate Arrangement Called the 'Snake' » *University of Toledo Law Review,* Vol. 10 (1978), pp. 47-72.

Monetary System and Related Issues (« the Committee of Twenty »). (6) The terms of reference of the Committee were to advise and report to the Board of Governors on all aspects of reform of the international monetary system, including amendment of the Articles. The Committee issued its report to the Board of Governors on June 14, 1974 and attached to the report an incomplete Outline of Reform. (7) The Committee was unable to reach agreement on a complete Outline because of problems related to inflation, the increased costs of energy, and other unsettling conditions. The Outline recorded the progress that the Committee had made in accordance with its terms of reference, indicated the general direction in which the Committee believed that the system could evolve in the future, and recommended certain immediate steps.

The Outline supported a number of features of the former par value system. A reformed system was described as one that would continue to be based an stable but adjustable par values. Members would be permitted, however, to adopt floating rates for their currencies in particular situations, which were not defined, subject to authorization, surveillance, and review by the Fund. The common denominator in which par values would be expressed would be the Fund's special drawing right (the SDR), which would be defined no longer in terms of gold. The SDR had come into existence as a result of the First Amendment of the Fund's Articles on July 28, 1969. It is a monetary asset that the Fund allocates to members as a supplement to the global total of reserve assets, and it is also a unit of account. The SDR was defined by the First Amendment as equivalent to 0.888 671 gram of fine gold.

Work on the amendment of the Articles began after the Committee of Twenty submitted its report to the Board of Governors. The work spread beyond the immediate steps the Committee had recommended and became a thorough overhaul of the Articles. The effort culminated in the Second Amendment. (8)

The provisions of the Second Amendment on exchange arrangements were among those that gave the greatest difficulty. The United States refused to commit itself to the maintenance of a par value or to the use of reserve assets in support of official convertibility for the U.S. dollar. The United States refused to agree that the Second Amendment should give any assurance that a par value system would ever be restored. Other members, particularly in Europe, sought some assurance of return at an appropriate date to a more controlled system, probably as described in the Outline, with greater symmetry in the rights and duties of members. In this context. greater

(6) Resolution No. 27-10, IMF *Summary Proceedings, Annual Meeting 1972,* pp. 353-56.

(7) IMF, *International Monetary Reform : Documents of the Committee of Twenty* (Washington, D.C., 1974), pp. 3-48.

(8) See *Proposed Second Amendment to the Articles of Agreement of the International Monetary Fund,* A Report by the Executive Directors to the Board of Governors (Washington, 1976); Joseph Gold, *The Second Amendment of the Fund's Articles of Agreement,* IMF Pamphlet Series, No. 25 (Washington, D.C., 1978).

symmetry meant a form of official convertibility, for which the expression « asset settlement » was coined. Asset settlement would enable members accumulating U.S. dollars in their reserves to exchange them for an international asset, but, in addition, would assure the United States of the receipt of this asset when it was in surplus in its balance of payments instead of a reduction in its currency liabilities.

The conflict was resolved by a compromise, but a compromise in appearance rather than in reality. Nothing like a par value system was restored when the Second Amendment became effective. Members are free to choose their exchange arrangements without any necessity for the concurrence of the Fund. The Articles state that the exchange arrangements may include maintenance by a member of a value for its currency in terms of the SDR or another denominator, other than gold, selected by the member. The purpose of the specific mention of this arrangement is promotion of the role of the SDR so that it can become the principal reserve asset in the international monetary system and the gradual decline in the role of gold. The Articles also mention cooperative arrangements by which members maintain the value of their currencies in relation to the value of the currency or currencies of other members. The purpose of the specific mention of this arrangement was to put the legality of « the snake » beyond controversy.

There was no logical need to refer to either kind of exchange arrangement because there is a portmanteau clause that refers to other exchange arrangements of a member's choice. (9) The legal freedom of members is subject to two exceptions, one of which is absolute and the other qualified. The absolute exception is maintenance of the external value of a currency in terms of gold. The Fund has no authority to permit this practice, which appears to be overlooked by the drafters of some bills introduced in the U.S. Congress in order to bring about a legal nexus between gold and the U.S. dollar. The other exception is multiple currency practices and discriminatory currency arrangements. This exception is qualified because the Fund has authority to approve these measures, (10) but it is unlikely that the Fund would approve deiscriminatory currency arrangements.

Members have freedom of choice but not freedom of behavior. Whatever exchange arrangements a member chooses, it must observe certain obligations. They are designed to achieve the consistency of exchange rates with the orderly underlying conditions that are necessary for financial and economic stability. The emphasis has been shifted from exchange stability in the original Articles to the stability of desirable economic and financial conditions. If these conditions do not exist, members should not pursue a policy of stable exchange rates because in these circumstances such a policy would probably obstruct the attainment of orderly underlying conditions.

The Fund's function is not to act as the licensor of exchange arrangements, but as the monitor of the administration by members of the exchange ar-

(9) On exchange arrangements, see Article IV.

(10) Article VIII, Section 3.

rangements they select. Choice, it should be added, is never final and does not estop a member from changing its arrangements as it sees fit. The Fund is to exercise « firm surveillance » (11) over the exchange rate policies of members so that it can satisfy itself that members are complying with their obligations. In order to perform its function of firm surveillance, the Fund adopts specific principles for the guidance of all members in their conduct of exchange rate policies, and consults with them to confirm that they are observing the principles.

To accord with the development of the international monetary system, the Fund may recommend general exchange arrangements to the membership at large. Members are not bound to follow a recommendation and may continue to exercise a free choice in the exchange arrangements that they prefer to apply. For a decision to recommend a general exchange arrangement, a majority of 85 per cent of the total voting power of members is necessary. If this majority can be assembled, it is likely that the recommendation will be followed by a substantial number of members. The Fund has not made any recommendation so far.

The elements in the compromise that has been referred to are not, on the one hand, members' freedom of choice and, on the other hand, the Fund's authority to recommend general exchange arrangements. Instead, the second element is the Fund's authority to decide that the par value system set forth in Schedule C of the Articles shall begin to operate. The compromise is not a realistic one because the par value system can be called into existence only if a majority of 85 per cent of the total voting power of members is in favor of the action. This majority gives the United States a veto. It may be assumed that the United States would have to change its present view of what is the best exchange arrangement for the dollar before it would concur in a decision to call the par value system of Schedule C into existence even though it would be more flexible than the former par value system and would not compel a member to establish a par value for its currency. It is also reasonable to assume that a considerable change in national policy would be necessary to induce the United States to concur in a decision to recommend a general exchange arrangement that, if observed by the United States, would limit its present freedom.

CATEGORIES OF EXCHANGE ARRANGEMENTS

The exchange arrangements of members are diverse. At the end of 1980, the exchange arrangements of 140 of the 141 (12) members of the Fund could be classified as shown below. The classification is a broad one because an attempt at further refinement would raise the problem of distinguishing between exchange arrangements and exchange policies.

(11) Article IV, Section 3(b).

(12) No information was available for Democratie Kampuchea.

Currencies pegged to:	
U.S. dollar	39
French franc	14
Sterling	1
Other currencies	3
SDR	15
Other composite of currencies	22
Adjusted according to a set of indicators	4
Cooperative exchange arrangements	8
Other arrangements	34
	140

This classification gives an inadequate impression of the diversity of exchange arrangements. For example, the category entitled «Other arrangements» includes currencies allowed to float independently but with discretionary management, as well as other practices, some of which apply to one currency only. In the other categories also, there are numerous differences among currencies, such as the differences in margins for exchange transactions established around the fixed relationship to another currency or composite of currencies to which a currency is pegged. (13)

EXCHANGE RATE VARIABILITY

Under the present Articles, a member is free not only to select its exchange arrangement but also to determine the value of its currency in relation to other currencies within the framework of its arrangement. As noted already, members, in exercising their freedom, must observe certain obligations, among which is the obligation to avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members. The Fund has considered this obligation to be sufficiently important to warrant the repetition of it among the three principles it has announced for the guidance of members' exchange rate policies (14) Nevertheless, the obligation is undefined and does not operate as a self-executing limitation on the freedom of members. The Fund has not gone beyond the listing of five situations that it will regard as *prima facie* evidence of the need to discuss with a member whether it is observing the announced principles. (15)

In the economic analysis of exchange rate movements, the Fund has distinguished among three types of variability : short-terms fluctuations of a

(13) Details of the exchange arrangements of individual members can be found in the Fund's *Annual Reports on Exchange Arrangements and Exchange Restrictions.* Classifications can be found in the Fund's *Annual Reports of the Executive Board* (hereinafter referred to as *Annual Report).*

(14) *Annual Report 1977,* p. 108.

(15) *Ibid.,* pp. 108-109.

day-to-day, week-to-week, or month-to-month kind; intermediate-term fluctuations over periods extending from one or two quarters to one or two years; and long-term shifts in exchange rates that persist. (16) It is not necessary here to pursue the question whether variability in any one or all of its three manifestations is inherent in members' freedom of choice or whether it has been the product of disturbed underlying conditions. (17) Nor is it useful to inquire here whether an international solution of the problem of exchange rates that differed from the Second Amendment and the present practice of the Fund would be feasible and more successful in promoting a stable system of exchange rates. (18)

For the present purpose, it is sufficient to note that there has been much variability of exchange rates, and that sometimes it has been erratic and not justified by underlying economic or financial conditions. (19) Variability, which is often better described as volatility, compounds the difficulties faced by the negotiators of treaties, whose confidence in the stability of exchange rates must take account, in any event, of the changes that have occurred in the law governing exchange rates.

UNITS OF ACCOUNT

(i) SDR

The elimination by the Second Amendment of gold as the common denominator in which to express the external value of currencies and the absence of a substitute pose not only the most obvious but also one of the most important problems in the drafting of new or amended financial provisions in treaties. The variability of exchange rates makes the problem even more urgent. The drafters of treaties must settle on a unit of account *de novo* or in substitution for a former unit of account. A number of units of account have been adopted in this process. The SDR is the one that has made most headway and that normally is considered first when a unit of account has to be chosen.

(16) *Annual Report 1979,* p. 34.

(17) « In some respects, exchange markets tend to behave like other financial markets : at times, they go through periods of unusual volatility, and it is not always evident, even with the benefit of hindsight, which economic forces have induced the increased volatility. For these reasons, shorter-term fluctuations — i.e., movements that reverse themselve within a day, a week, or a month — cannot always be distinguished, at the time of their occurrence, from the longer-term movements of exchange rates spanning several quarters or perhaps years. A large irreversible shift in the exchange rate may occur within a short period of time, and long-term readjustments are often accompanied by large short-term fluctuations. » (*Annual Report 1980,* p. 47).

(18) Jacob S. Dreyer, Gottfried Haberler, and Thomas D. Willett, eds., *Exchange Rate Flexibility* (Washington, D.C., 1978).

(19) « Periods of relative stability of rates alternated with phases of instability, during which exchange rate fluctuations were perceived as excessive in relation to the adjustments required to offset divergencies in underlying price and current account developments. » (*Annual Report 1980,* p. 41)

Since the breakdown of the par value system, the method of valuing the SDR has gone through three transformations. The first stage occurred while the SDR was still defined by the Articles in terms of gold. It was impossible, however, to find any currency that was maintained in value in relation to gold through which the values of other currencies could be arrived at in terms of the SDR. The Fund decided, as a necessary legal fiction, to attribute the gold value of the SDR to the market value of a « basket » of defined amounts of 16 specified currencies. This method of valuation became effective on July 1, 1974. (20)

Thé virtue of the SDR and of other units of account composed of currencies is that these units of account are likely to be more stable in exchange value in relation to currencies in the basket, and perhaps currencies in general, than any one currency. The SDR, for example, represents a balanced combination of currencies that have leading roles in the commercial and financial activities of the world. This balance moderates the variability of exchange rates for individual currencies. The effect of the depreciation of one currency in the basket may be counterbalanced or reduced by the appreciation of another currency. In additon, the effect of a change in the exchange value of a currency is modified by its weight in the basket.

The original basket for the valuation of the SDR was changed with effect on July 1, 1978, but it continued to consist of 16 currencies. In this second transformation, two of the original currencies were extruded from the basket and two new currencies were included, and adjustments were made in the number of units of the currencies that remained in the basket. In the third stage, a revised basket took effect on January 1, 1981. It is composed as follows :

Currency	*Weight (in per cent)*	*Amount (in units of each currency)*
U.S. dollar	42	0.54
Deutsche mark	19	0.46
Japanese yen	13	34
French franc	13	0.74
Pound sterling	13	0.071

(20) On this and various other topics discussed in this article, details can be found in the following five contributions by the present author to the Fund's Pamphlet Series : *Floating Currencies, Gold, and SDRs : Some Recent Developments,* No. 19 (1976); *Floating Currencies, SDRs, and Gold : Further Legal Developments,* No. 22 (1977); *SDRs, Gold, and Currencies : Third Survey of New Legal Developments,* No. 26 (1979); *SDRs, Currencies, and Gold : Fourth Survey of New Legal Developments,* No. 33 (1980); *SDRs, Currencies, and Gold : Fifth Survey of New Legal Developments,* No. 36 (1981).

The reasons for the spreading use of the SDR as the unit of account for the purposes of treaties are manifold. Some reasons may apply to all treaties while others have less than general relevance. The fact that the SDR is the unit of account of the central organization of the international monetary system is probably always a reason, whether conscious or not, for following the lead of the Fund. Equal importance attaches to the Fund's publication of the exchange rates for a long list of currencies in terms of the SDR, and the use that can be made of these rates for arriving at the exchange rates for other currencies in terms of the SDR. The Fund has sought to ensure that this information will be available for any date for which it might be required. Publication by the Fund makes it unnecessary for other public and private entities to collect data and make their own calculations. Furthermore, the exchange rates published by the Fund are treated by other entities as authoritative, and therefore these rates help to avoid disputes.

Other, and perhaps less general, reasons for the choice of the SDR as the unit of account include the publicity that the Fund gives to the principles according to which it will adapt the method of valuation at stated intervals unless for good reason the Fund decides on some occasion to depart from the announced principles. (21) Changes are not merely predictable. They can be seen to follow from the consistent application of reasonable principles. Changes will be made at quinquennial intervals, which gives an assurance that the method of valuation will be adapted to current conditions but at periods that are not so frequent as to provoke the fear of instability. Decisions to change the method of valuation require a majority of 70 per cent of the total voting power of members, but a majority of 85 per cent is necessary for a change in the principle of valuation or a fundamental change in the application of the principle in effect. (22) These high majorities reinforce the assurance that changes will not be made lightly, or in the interest of any one class of members, because of the support that must exist among all classes of them.

Furthermore, it is known that certain considerations have guided the Fund is establishing the principles for adapting the method of valuation, whether or not these considerations are made explicit in the Fund's decisions. Among these considerations are the desirability of including in the valuation basket currencies that are sufficiently representative of the total international commercial and financial transactions of members, and the desirability of weighting the currencies in accordance with the relative importance of members in these transactions. Stability in the selection of currencies for inclusion in the basket and in the weights attributed to them is another consideration.

Continuity is also a consideration. Changes in the method of valuation should not yield values for the SDR in terms of currencies that are likely to

(21) IMF *Press Release* No. 80/66 (September 18, 1980).

(22) Article XV, Section 2.

vary substantially from the values that prevailed before a change. Moreover, the Fund makes certain that these values will be the same on the day on which a change in the method of valuation becomes effective as they were on the previous day. A smooth transition is ensured, but of course the exchange rates of currencies in terms of the SDR will diverge after the transition from what they would have been under the former method of valuation. The continuity of value achieved by a smooth transition avoids an abrupt change in the presentation of assets and liabilities and in the conduct of business in which the SDR is the unit of account.

Sometimes, a reason for the adoption of the SDR when a treaty is being modified is that the unit of account in the treaty is defined in terms of gold. It is simple, therefore, to substitute the SDR by applying the ratio between the definition in terms of gold of the SDR before the Second Amendment of the Fund's Articles and the definition of the original unit of account in the treaty undergoing amendment. This technique, coupled with the fact that the SDR is the unit of account of the Fund, has enabled the administrators of some treaties to adopt the SDR as the unit of account without amendment of the treaty.

Another influence in the field of treaties has been imitation. The negotiators of a new treaty or of the amendment of an existing treaty dealing with a particular activity are disposed to follow the example of other treaties dealing with the same or a similar activity.

The SDR has been adopted as the unit of account for specified purposes under a growing number of new or amended treaties. Some are already in effect and others are in the process of ratification. They can be classified according to the categories set forth below. It will be noted that although most of the treaties permit universal adherence, a substantial number are designed for regional activities.

Economic integration

Treaty of the Economic Community of West African States (ECOWAS), 1975. (23)

Financial activities

Agreement Establishing the Asian Clearing Union, 1976. (24)

Agreement Establishing the Common Fund for Commodities, 1980. (25)

Agreement Establishing the International Fund for Agricultural Development, 1976. (26)

Agreement on Short-Term Foreign-Exchange Assistance between the central banks in Denmark, Finland, Iceland, Norway, and Sweden, 1976. (27)

(23) *International Legal Materials,* Vol. XIV (1975), pp. 1200-1209.

(24) Michael Haas, ed., *Basic Documents of Asian Regional Organizations,* Vol. VI (New York, 1979) (hereinafter referred to as *Asian Basic Documents),* pp. 174-93.

(25) U.N. Document TD/IPC/CF/CONF. 24.

(26) *International Legal Materials,* Vol. XV (1976), pp. 916-49.

(27) Danmarks Nationalbank, *Report and Accounts for the year 1975* (Copenhagen), Annex 5, pp. 95-96.

Articles of Agreement of the Arab Monetary Fund, 1976. (28)

Articles of Agreement of the Islamic Development Bank, 1974.

Nordic Investment Bank, 1975. (29)

Postal services

Protocol Amending Convention of Universal Postal Union, 1979. (30)

Products liability

European Convention on Products Liability in Regard to Personal Injury and Death, 1979. (31)

Trade

Agreement on Government Procurement, 1979. (32)

Transportation by air

Additional Protocol No. 1 to Amend the Convention for the Unification of Certain Rules Relating to International Carriage by Air signed at Warsaw on October 12, 1929.

Additional Protocol No. 2 to Amend the Convention for the Unification of Certain Rules Relating to International Carriage by Air signed at Warsaw on October 1929 as amended by the Protocol done at The Hague on September 28, 1955.

Additional Protocol No. 3 to Amend the Convention for the Unification of Certain Rules Relating to International Carriage by Air signed at Warsaw on October 12, 1929 as amended by the Protocol done at The Hague on September 28, 1955 and Guatemala City on March 8, 1971.

Montreal Protocol No. 4 to Amend the Convention for the Unification of Certain Rules Relating to International Carriage by Air signed at Warsaw on October 12, 1929 as amended by the Protocol done at The Hague on September 28, 1955.

(The Montreal Protocols, 1975). (33)

Transportation by sea and maritime matters

Convention on the Carriage of Goods by Sea (the Hamburg Rules), 1978. (34)

Convention on Civil Liability for Oil Pollution Damage Resulting from Offshore Operations, 1976. (35)

(28) Unofficial translation (International Monetary Fund).

(29) Publication of Nordic Investment Bank (Stockholm).

(30) Not yet published.

(31) *International Legal Materials,* Vol. XVI (1977), pp. 7-12.

(32) GATT Document MTN/NTM/W/211/Rev. 2; *International Legal Materials,* Vol. XVIII (1979), pp. 1050-78.

(33) *Revue française de droit aérien,* 1976, pp. 66-102.

(34) *International Legal Materials,* Vol. XVII (1978), pp. 603-31.

(35) Ibid., Vol. XVI (1977), pp. 1450-55.

Convention on International Multimodal Transport of Goods, 1980. (36)

International Convention on Limitation of Liability for Maritime Claims, 1976. (37)

Protocol Amending the International Convention Relating to the Liability of Owners of Sea-Going Ships, 1980 (38)

Protocol Amending the International Convention for the Unification of Certain Rules of Law Relating to Bills of Lading, 1980. (39)

Other forms of transportation

Protocols to :

Convention on the Contract for the International Carriage of Passengers and Luggage by Road (CMR), 1978. (40)

Convention on the Contract for the International Carriage of Passengers and Luggage by Road (CVR), 1978. (41)

Convention Relating to the Limitation of the Liability of Owners of Inland Navigation Vessels (CLN), 1978. (42)

Convention on the Contract for the International Carriage of Passengers and Luggage by Inland Waterway (CVN), 1978. (43)

Revised Convention for Rhine Navigation. (44)

Normally, the SDR is referred to as such when it is chosen as the unit of account, but sometimes, for political or other reasons, the drafters resort to indirection. For example, the unit of account of the Asian Monetary Union is the Asian Monetary Unit (AMU), which is defined as equivalent to one SDR. The unit of account of the Arab Monetary Fund is the Arab dinar, which is equivalent to three SDRs. Perhaps the unit of account of these two organizations is not named the SDR because, as discussed later, the organizations are authorized to depart from the SDR as their unit of account.

The unwillingness of certain nonmembers of the Fund to refer to the Fund or the SDR is a political reason for greater obscurantism in referring to the SDR. The Agreement Establishing the Common Fund for Commodities defines the value of the unit of account that is employed for specified purposes as the sum of the values of prescribed amounts of 16 currencies. The definition accords with the second stage of the Fund's basket method of

(36) U.N. Document TD/MT/CONF./16; *International Legal Materials,* Vol. XIX (1980), pp. 938-57.

(37) Inter-Governmental Maritime Consultative Organization (IMCO), LEG/CONF. 5/10.

(38) Not yet published.

(39) Not yet published.

(40) ECE/TRANS./34.

(41) ECE/TRANS./35.

(42) ECE/TRANS./32.

(43) ECE/TRANS./33.

(44) Not yet published.

valuing the SDR, which took effect on July 1, 1978. The Agreement Establishing the Common Fund provides that any change in the list of curencies, or in their weights, shall be made by the Governing Council in conformity with the practice of « a competent international monetary organization ». (45) The Executive Board of the Common Fund must determine the method of valuation of usable currencies in terms of the unit of account « in accordance with prevailing international monetary practice. » (46) The understanding of the negotiators of the Agreement was that this language referred to the Fund and its practice. This kind of allusiveness, however, is not a common feature of treaties to which nonmembers of the Fund have adhered or are expected to adhere.

Some nonmembers have alleged that they have legal difficulties in subscribing to a treaty in which the SDR would be the only unit of account. A number of solutions have been found to resolve these difficulties. The four Montreal Protocols on transportation by air of passengers, baggage, mail, and cargo represent one model. According to that solution, if the law of a nonmember of the Fund does not impede the application of the SDR, the nonmember may decide for itself how the value of the SDR in terms of its currency is to be calculated. (This part of the solution is in contrast to the provision of the Agreement Establishing the International Fund for Agricultural Development (IFAD) under which the IMF calculates the value of a nonmember's currency in terms of the SDR on the basis of an appropriate exchange rate relationship between the currency and the currency of a member. (47) Under the IFAD Agreement, therefore, only one unit of account is in existence.) Under the Montreal solution, if a nonmember's law precludes application of the SDR, the nonmember may apply the Poincaré franc. (48) The result is that two units of account will coexist with no tie between them. This solution does not ensure uniformity, which is an objective of many treaties, and can encourage the « forum shopping » that these treaties are designed to discourage. The Montreal solution has been followed for the purposes of other treaties, one example of which is the International Convention on Limitation of Liability for Maritime Claims, 1976.

The Convention on the Carriage of Goods by Sea, 1978 represents a different solution, the purpose of which is to achieve uniformity between the SDR as the « unit of account » and a « monetary unit ». Once again, a nonmember whose law permits application of the SDR may determine how the value of its currency in terms of the SDR is to be calculated. If the nonmember's law prevents application of the SDR, the nonmember may prescribe limits of liability under the treaty in amounts expressed in terms of a « monetary unit » according to the ratio of 15 monetary units to the SDR.

(45) Shedule F.

(46) Article 1(8); Article 8, paragraph 1.

(47) Article V, Section 2.

(48) See, for example, Article VII of Montreal Protocol No. 4 to Amend the Convention for the Unification of Certain Rules Relating to International Carriage by Air, signed at Warsaw on October 12, 1929.

The definition of the monetary unit makes it equivalent to the Poincaré franc, and the ratio results from the former definition of the SDR in terms of gold and the definition of the Poincaré franc. The translation into a nonmember's currency of the SDR or the monetary unit must be made in such manner as will approximate as closely as possible the « real value » of the amounts of members' currencies expressed in SDRs. (49) This, the Hamburg solution, recognizes only one unit of account and attempts to ensure uniform results even if the monetary unit is applied. The Convention on International Multimodal Transport and the Protocols Amending the International Convention Relating to the Limitation of the Liability of Owners of Sea-Going Ships and the International Convention for the Unification of Certain Rules of Law Relating to Bills of Lading, 1979, are other treaties that adopt the Hamburg solution. It may be followed more often than the Montreal solution.

(ii) OTHER UNITS OF ACCOUNT

In the practice of states, the SDR is not the only unit of account composed of currencies. The development of a unit of account for the purposes of the European Community has a long history. It did not begin at the end of 1974, but on December 13 of that year the Commission sent to the Council a study recommending the gradual introduction of a new unit of account for all the purposes of the Community in place of the varied units of account then in use. The Commission concluded that the new unit of account should reflect actual exchange rates and should not be linked to a single currency or to the currencies of the « snake ». Linking the unit of account to the central rates of all currencies of the Community was not satisfactory because they were not all floating jointly. The solution, therefore, was to link the unit to the average movement of a basket of the currencies of all members of the Community, weighted according to appropriate economic factors.

The SDR was considered but was not recommended because the SDR basket consisted at that time of Community currencies only to the extent of 44.5 per cent and did not include the currencies of two members of the Community, Iceland and Luxembourg. Moreover, the U.S. dollar accounted for 33 per cent of the SDR basket. So heavy a weight was thought to be undesirable for intra-Community activities and for relations between the Community and nonmember states. A truly European unit of account was needed that would be more likely to contribute to the monetary integration of the Community. The SDR, in all its transformations, has been designed to meet universal needs.

A decision of the Council as of April 21, 1975 introduced the European Unit of Account (EUA) for the financial activities of the Community. (50) The objective was gradually to replace the gold unit of account that was

(49) Article 26, paragraph 4.

(50) *Official Journal of the European Communities*, Vol. 18, No. L 104, p. 35.

included in the Treaty of Rome but had become unworkable. The new unit was composed of specified amounts of the currencies of the nine countries that were then members of the Community. The initial value of the EUA was made to equal the initial value of the SDR, perhaps because the definition in terms of gold of the unit of account in the Treaty of Rome (51) was almost the same as the definition of the SDR in the Fund's Articles at that time.

The European Monetary System (EMS), which is discussed below, came into existence on March 13, 1979 with the European Currency Unit (ECU) at its centre. Its initial composition was the same as the composition of the EUA on March 13, 1979 :

Currency	Amount of currency	Percentage of total	ECU = currency units
Deutsche mark	0.828	33.0	2.510641
French franc	1.15	19.8	5.798311
Pound sterling	0.0885	13.3	0.663247
Netherlands guilder	0.286	10.5	2.72077
Belgian franc	3.66	9.6	39.4582
Luxembourg franc	0.14		
Italian lira	109.00	9.5	1,148.15
Danish krone	0.217	3.1	7.08592
Irish pound	0.00759	1.2	0.66238

Both the EUA and the ECU have been the unit of account in multilateral and bilateral treaties entered into by the Community. It can be expected that a unit of account such as the ECU will be used in a variety of treaties. A unit of account may be designed, however, for a single treaty, and although a broader use is not precluded by law, such a use is unlikely. The unit of account of the International Natural Rubber Agreement, 1979, the Malaysian/Singapore cent, is of this character. It is defined as « the average of the Malaysian sen and the Singapore cent at the prevailing rates of exchange. » (52) The sen and the cent are fractional units of the Malaysian ringgit and the Singapore dollar, respectively.

(51) Article 4 of the Protocol of the Treaty of Rome on the Statute of the European Investment Bank.

(52) Article 2(16).

CHANGE TO NEW UNIT OF ACCOUNT

The revision of a unit of account must be distinguished from the abandonment of a former unit of account and the choice of a new one. The uncertainties of existing exchange arrangements probably contribute to decisions to incorporate in treaties authority to choose a new unit of account.

Before examples of this practice are discussed, it should be noted that some treaties have provided for the automatic application of a unit of account when it came into existence or for the automatic substitution of a new unit of account, when created, for one already in existence. Under the Lomé Convention, 1975 between members of the European Community and the Council of the Community, of the one part, and 46 African, Caribbean, and Pacific (ACP) countries, of the other part, done on February 28, 1975, the Community undertook to provide a specified total amount of financial assistance expressed in « units of account ». (53) An Annex to the Final Act of the Lomé I Meeting contained a declaration by the Community that the amount of the Community's financial assistance as stated in the Convention would be the equivalent in the European unit of account, when defined, of SDRs at their value on June 28, 1974. (54) The declaration went on to announce that this provision would not prejudice the decision that the Council would have to take on the question whether the SDR or a basket of currencies of members of the Community would determine the composition of the European unit of account. The Council's decision would be taken as soon as possible and before entry into force of the Convention at the latest. The decision that established the EUA also provided that it was to apply to the First Lomé Convention.

The imminence of the ECU was responsible for its automatic substitution for the EUA under the Second Lomé Convention, of October 31, 1979. (55) The amount of financial assistance to be available to the ACP countries was expressed in EUAs. (56) The Final Act of the Lomé II Meeting contains a declaration by the Community that the Council of the Community might decide to replace the EUA by the ECU for the purposes of the Convention. Moreover, if such a decision were taken, the ECU would be applied to operations initiated or to be initiated under existing Conventions entered into as a result of the First Lomé Convention. (57)

The Agreement Establishing the Asian Clearing Union, 1973 is an example of a treaty under which a discretion exists to change the unit of account. The treaty provides that the accounts of the Union are to be kept in

(53) Article 42; *International Legal Materials,* Vol. XIV (1974), p. 614.

(54) Annex XVII, *ibid.,* p. 599. June 28, 1974 preceded the effective date of the valuation of the SDR according to a basket of currencies. The technique, therefore, was to go from the gold unit of account in the Treaty of Rome to the SDR as defined in gold and then to the EUA.

(55) By that date, the number of ACP countries had grown to 58.

(56) Article 95; *International Legal Materials,* Vol. XIX (1980), p. 359.

(57) Annex XXXII; *ibid.,* p. 339.

terms of the Asian Monetary Unit (AMU), the value of which is equivalent to one SDR. The Board of Directors is authorized to change the value of the AMU at any time by a unanimous vote of all directors. A director appointed by a participant whose currency has changed in value in terms of the SDR since the entry into force of the Agreement, in an amount at least equivalent to and in the same direction as the proposed change in value of the AMU, is deemed to vote in favor of the proposed change. This unusual provision creates a kind of estoppel by behavior of a currency. If a change is made, outstanding net debtor and creditor positions are be be settled on the basis of the value of the AMU preceding the change. (58)

It has been suggested above that authority of the Union to change the method af valuing the AMU without reference to the SDR may be a reason why the unit of account is not named the SDR. Another reason appears to be concern that the Fund might cease at any time to announce the daily rates of exchange for various currencies in terms of the SDR. (59)

The unit of account of the Arab Monetary Fund is the Arab dinar, the value of which is defined as equal to three SDRs. The Board of Governors, the senior organ, may adjust this value and the method of valuation of the Arab dinar by a three-fourths majority of the voting power. (60)

It has been seen that the unit of account of the International Natural Rubber Agreement, 1979, the Malaysian/Singapore cent, is a combination of two currencies in the form of an average of the Malaysian sen and the Singapore cent at prevailing exchanges rates. Changes in the exchange rate between the two currencies may be disturbing. The Agreement provides, therefore, that if divergency develops between the two currencies that significantly affects buffer stock operations, the Council shall meet to review the situation and may consider the adoption of a single currency. (61) The Agreement differs from other treaties in establishing a criterion for departure from the original unit of account and in providing guidance on the character of the new unit of account.

The Statutes attached to the Agreement regarding the Establishment of the Nordic Investment Bank, 1975 express the capital stock of the Bank in terms of the SDR (62) and provide that the accounts shall be kept in that unit of account. (63) The SDR is defined in accordance with the Fund's method of valuation in effect since July 1, 1974, but apparently this formulation means in effect on July 1, 1974. If this method of valuation is changed, the Board of

(58) Article IV; *Asian Basic Documents,* pp. 176-77.

(59) *Asian Basic Documents,* p. 197.

(60) Article Twelve.

(61) Article 40, section 3.

(62) Paragraph 2.

(63) Paragraph 9.

the Bank must decide to what extent the Bank is to follow the new method. (64) It is not clear whether the only choice available to the Bank is to retain the former method of valuing the SDR or whether the Board has a broader discretion. The language can be read more restrictively than the language that gives the Asian Clearing Union authority to change its unit of account.

The Agreement on short-term foreign-exchange assistance entered into by the central banks of Denmark, Finland, Iceland, Norway, and Sweden in 1976 seems clearly to confine a discretion to depart from the unit of account to a choice between the former and the revised method of valuing the SDR. When a central bank repays indebtedness under the agreement after a change in the method of valuing the SDR, which is the unit of account, the parties are to decide whether the revised method of valuation is to apply. (65)

A further distinction must be noted in relation to units of account. Some treaties authorize not the adoption of a new unit of account but the retention of an earlier method of valuing the same unit of account when the method is changed. This practice may have its disadvantages, for example in provoking confusion, but once again the variability of exchange rates may be responsible for the practice. The retention of an earlier method of valuing the unit of account may give obligors certainty in measuring the payments they will have to make in currency as well as reassurance that they will not suffer loss as a consequence of a change in the method of valuation.

The Agreement Establishing the Common Fund for Commodities contains a provision of this kind. Each member has an option to pay the share of directly contributed capital to which it subscribes in (a) any usable currency at the prevailing rate of exchange between the currency and the unit of account (i.e., in effect the SDR), or (b) in a usable currency selected by the member at the time of depositing its instrument of adherence at the rate of exchange between that currency and the unit of account at the date of the Agreement (June 27, 1980). A member exercises its option at the time of the deposit of the instrument, and its choice is final. (66) Option (b) seems designed to give members certainty. For this reason, the rate of exchange between the currency of payment and the unit of account is probably intended to mean the unit of account according to the method of valuation prevailing on June 27, 1980 and not the unit of account according to a revised method of valuation. This interpretation will have immediate importance because the Fund's method of valuing the SDR was changed with effect at a date later than June 27, 1980.

The European Convention on Products Liability in Regard to Personal Injury and Death, 1977 permits a state when becoming a party to limit the amount of compensation to be paid by a producer, provided that the limits

(64) Paragraph 2.

(65) *Danmarks Nationalbank Report and Accounts for the year 1973,* pp. 95-96.

(66) Article II, paragraph 1.

are not less than the equivalent in national currency at the amounts of SDRs specified in the Convention. The method of valuing the SDR for this purpose is the one in force at the date when a state ratifies the Convention. (67)

The Agreement Establishing a Financial Support Fund of the Organization for Economic Co-operation and Development was done on April 9, 1975, but apparently it will not take effect. The SDR according to the IMF's method of valuation that became effective on July 1, 1974, which means the original basket method of valuation, is the unit of account for the purposes of this Agreement. A change by the IMF in the method of valuation is not to be substituted automatically for the purposes of the Agreement. The revised method would be substituted only if the Governing Committee took a decision to this effect, in which event the revised method would apply to transactions carried out after the decision, unless the Governing Committee decided otherwise by a 90 per cent majority of voting power. (68)

The Agreements discussed above under which the SDR as a unit of account is, or can be, « frozen » provide that it shall be frozen as of a specified date, or as of a defined date that may differ among contracting parties, or as of a specified date but subject to unfreezing in certain circumstances.

PROCEDURES FOR ADOPTING NEW UNIT OF ACCOUNT

The discussion in the preceding section of this article has shown that under some agreements an organ of the international institution governed by the treaty is authorized to change the unit of account. Under other treaties, no such authority is granted but provision is made for a special procedure for making changes of this kind. The procedure is sometimes easier to follow than it would be for other purposes. The Convention on Limitation of Liability for Maritime Claims, 1976 is an example of such a treaty. It has been seen that the Convention establishes limits on liability expressed in SDRs and permits nonmembers of the Fund to apply limits in terms of a monetary unit that corresponds to the Poincaré franc. A Conference may be called for the purpose of altering the amounts specified as limits or of substituting a new unit or units for the SDR or the Poincaré franc or both. The Inter-Governmental Maritime Consultative Organization, which is to administer the Convention, must convene a Conference at the request of at least one-fourth of the parties to the Convention. (69) Conferences for the purpose of

(67) Annex; *International Legal Materials,* Vol. XVI (1977), p. 12.

(68) Article XIV; *International Legal Materials,* Vol. XIV (1975), pp. 997-98. The Governing Committee's authority to apply the IMF's revised method is subject to the condition that it is compatible with the provision (Article III, Section 2; *ibid.,* p. 984) under which a member's quota determines the member's maximum financial liability to meet the obligations incurred by the Financial Support Fund.

(69) Article 21; *International Legal Materials,* Vol. XVI (1977), p. 615.

considering other amendments must be called on the request of a higher proportion of the parties, namely one-third. (70)

A special provision is adopted for entry into force of a decision to alter the amounts or to substitute new units. A decision can be taken by a two-thirds majority of the parties present and voting in the Conference. (71)

ADAPTATION TO CHANGES IN EXCHANGE RATES

The prospect of changes in exchange rates induces the drafters of some treaties to make provision for adapting the terms of the treaties. Buffer stock agreements are among the treaties that contain provisions of this kind, because changes in exchange rates may affect market prices for the commodity that is the subject of the agreement. The Fifth International Tin Agreement, 1975, (72) provides that the Executive Chairman, the chief executive official of the buffer stock organization, may convene, or any participating country may request him to convene, an immediate session of the International Tin Council to review the floor and ceiling prices if the Executive Chairman or the member considers that changes in exchange rates make such a review necessary. Prices are expressed in Malaysian ringgits or in any other currency that the Council selects. (73)

The Council must meet if the Executive Chairman or a participating member calls for a session. Pending such a session, the Executive Chairman may suspend or restrict the operations of the buffer stock provisionally if he considers this action necessary to avoid prejudice to the purposes of the Agreement. The Council may confirm, amend, or cancel his action. In the absence of a decision, operations are resumed.

Within 30 days of the Council's decision to confirm, amend, or cancel a suspension or restriction of operations, the Council must consider, and may determine, provisional floor and ceiling prices. In the absence of a decision on provisional prices, existing prices continue to apply. Within 90 days from the establishment of provisional prices, the Council must review them and may determine new prices. If new prices are not determined, the provisional prices remain in effect. If provisional prices within the period of 30 days referred to above are not determined, the Council may determine prices at any subsequent session. (74) Special majorities are not required for the Council's decisions.

(70) Article 20; *ibid.* For three other Conventions for which a similar procedure is provided, see *ibid.*, pp. 617-30.

(71) Article 21, paragraph 3; *ibid.*, p. 615.

(72) June 24, 1975; U.N. Document TD/TIN. 5/10; *International Legal Materials,* Vol. XIV (1975), pp. 1149-99.

(73) *Ibid.*, Article 27, p. 1172.

(74) *Ibid.*, Article 31, pp. 1174-75.

Under the International Sugar Agreement, 1977, (75) prices are expressed in U.S. cents. (76) The International Sugar Council, the highest organ of the International Sugar Organization, must review the prices referred to in the Agreement at specified intervals. In conducting these reviews, the Council is directed to take into consideration all factors that might affect achievement of the objectives of the Agreement, including certain specified factors, among which are variations in exchange rates and the influence on prices for sugar of changes in the world economic situation or monetary system.

In the light of a review, the Council may make such adjustments in prices for the next quota year as it deems necessary to maintain the objectives of the Agreement, provided that the spread between maximum and minimum prices remains 10 cents per pound. A special majority is required for these decisions. The Council must appoint a Price Review Committee, with a membership as prescribed by the Agreement, to collect data and submit findings to the Council that will assist it to perform its task of reviewing prices. In exceptional circumstances resulting from upheavals in the international economic or monetary situation, or whenever a major change occurs in the value of the U.S. dollar, the Committee shall meet to consider the situation. In the light of its examination, the Committee may request a special session of the Council to consider what action to take, including any necessary adjustment in prices. Any adjustment takes effect forthwith. A special majority is required for decisions to make these adjustments. (77)

The provisions on changes in exchange rates in the International Natural Rubber Agreement, 1979, (78) are, to a large extent, similar to those of the Fifth International Tin Agreement. The Executive Director, who is the chief administrative officer of the International Natural Rubber Organization, is required, and not simply empowered, to call for a special session of the International Natural Rubber Council, the highest organ, if the exchange rate between the Malaysian ringgit/Singapore dollar and the currencies of all major natural rubber exporting and importing members changes to the extent that the operations of the buffer stock are « significantly affected ». A majority of exporting or of importing members, or a group in either category holding a specified minimum number of votes, may call for a special session. (79)

The Council must meet within 10 days to confirm or cancel measures already taken by the Executive Director after consultation with the Chairman of the Council. (80) The Council, acting with a special majority,

(75) October 7, 1977; U.N. Document TD/SUGAR. 9/10; *U.S. Treaties and Other International Acts Series* 9664 (1977).

(76) *Ibid.,* Article 2(19), p. 5; Article 44, pp. 34-35.

(77) *Ibid.,* Article 62, p. 49.

(78) October 6, 1979; U.N. Document TD/RUBBER/15, Rev. 1.

(79) *Ibid.,* Article 14.

(80) *Ibid.,* Article 37.

may decide to take appropriate measures, which may include revision of the price range in accordance with principles included in the Agreement. (81)

The Council, again acting with a special majority, must establish a procedure to determine what is to be treated as a significant change in the exchange rates (« parities ») of the currencies referred to above for the purpose of the timely convening of the Council. (82)

The International Cocoa Agreement, 1980 (83) contains provisions comparable to those of the other buffer stock agreements. The criterion for invoking the corresponding procedure under the Cocoa Agreement is that « conditions on the foreign exchange markets are such as to have important implications for the price provisions » of the Agreement. (84) Special sessions of the Council must convene within four working days. Prices under the Agreement are expressed in U.S. cents. (85)

The Agreement Establishing the Common Fund for Commodities refers to exchange rate fluctuations in connection with subscriptions of additional shares of directly contributed capital. The Governing Council is to review the adequacy of subscriptions, and as a result it may decide, by a special majority, to make available for subscription unsubscribed shares or to issue additional shares of directly contributed capital. When undertaking a review, the Governing Council must review the operation of the method of payment, « in the light of exchange rate fluctuations, and, taking into account developments in the practice of international lending institutions, » and may decide by a special majority, what, if any, changes to make in the method of payment of additional subscriptions. (86) The provision is not clear but seems to create authority that would include authority to permit payment on the basis of exchange rates between a currency and the unit of account prevailing at an appropriate date other than the date that applies to original subscriptions.

The Convention on a Code of Conduct for Liner Conferences (87) contains criteria for the determination of freight rates and for increases in them. Changes in exchanges rates, « including formal devaluation or revaluation, » that lead to changes in the aggregate costs or revenues, or both, of the

(81) *Ibid.,* Article 32.

(82) *Ibid.,* Article 40.

(83) October 27, 1980; U.N. Document TD/COCOA.6/7.

(84) *Ibid.,* Article 38.

(85) *Ibid.,* Article 27.

(86) U.N. Document TD/IPC/CF/CONF./24, Article 11, paragraph 2, and Article 12.

(87) *International Legal Materials,* Vol. XIII (1974), pp. 912-48.

shipping lines constituting a conference, attributable to operations within the conference, are deemed a valid reason for the introduction of a currency adjustment factor or for a change in freight rates. The adjustment or change is to be no more than eliminates aggregate gain or loss for the member lines. A procedure for consultation between the conference and the other parties directly affected is to be followed, save in exceptional circumstances that warrant immediate action, but consultation is then to be held as soon as possible after that action. Consultations must be completed within 15 days, and if agreement is not reached in this period, the provisions for settlement of disputes must be followed. (88)

MAINTENANCE OF VALUE

The expression « maintenance of value » has been given at least three different meanings in relation to financial contributions to, or holdings of currency by, international organizations under treaties :

(i) contributions made at different times are made on the basis of the same unit of account;

(ii) the exchange value of an organization's holdings of a member's currency are maintained by adjustments between the member and the organization;

(iii) the economic value of an organization's holdings of a member's currency are maintained by adjustments between the member and the organization.

Efforts have been made and are continuing under some international auspices to arrive at an acceptable formula for the calculation of economic value, but agreement has yet not been reached. No international obligations based on the third meaning are in existence so far.

The first meaning is based on obvious equity among members and is a normal feature of many treaties. It has been seen, however, that under some treaties a unit of account applies to most contracting parties, while other parties have the option of a monetary unit. Furthermore, under some treaties, an earlier method of valuation of the same unit of account may apply to some but not all contracting parties.

Maintenance of value in the second sense also has been a common feature of financial treaties. Under the Fund's original Articles the gold value of all the Fund's holdings of currency were maintained notwithstanding changes in the par value of a currency or in its foreign exchange value if it was floating. (89) The rationale in the case of the Fund was the preservation of its financial equilibrium, as well as the assurance that it would be able to

(88) *Ibid.*, Article 17, pp. 930-31.

(89) Article IV, Section 8. Joseph Gold, *Maintenance of the Gold Value of the Fund's Assets*, IMF Pamphlet Series, No. 6 (Washington, D.C., 2nd ed., 1971).

conduct its financial activities without facing an exaggerated demand for an appreciated currency or the absence of demand for a depreciated currency. These objectives were achieved by requiring the Fund to conduct its financial activities at the exchange rate on the basis of which its holdings were adjusted under the provisions on maintenance of value. Similar considerations may explain the provisions on maintenance of value in other financial treaties. A consideration unique to the Fund was its regulatory functions in relation to the external value of currencies, which made it desirable to protect the Fund against any charge of financial self-interest in the performance of those functions.

The variability of exchange rates has reduced the willingness of some members to undertake maintenance of value obligations in the second sense. Fluctuations in the value of the U.S. dollar in terms of the SDR as the Fund's unit of account have raised difficulties in connection with appropriating legislation in the United States. Uncertainty about the amount in U.S. dollars that the United States might be called upon to provide, the possible frequency of payments, and the fact that exigibility results from market forces and not the deliberate action of the monetary authorities combine to explain the recent reluctance of the U.S. Administration to accept new obligations to maintain the value of holdings of U.S. dollars by international organizations, including the Fund.

The legislation relating to the participation of the United States in the arrangements to lend to the Fund to finance its Supplementary Financing Facility (the Witteveen Facility) illustrates the difficulty as seen by the United States. The authorizing legislation empowered the United States to lend a maximum amount of dollars equivalent to SDR 1,450 million. (90) The appropriating legislation quantified this amount, at current exchange rates in terms of the SDR, at $ 1,831,640,000. (91) Fluctuations in the value of the U.S. dollar in terms of the SDR, however, might make this amount inadequate under the Fund's borrowing agreement with the United States. The Secretary of the U.S. Treasury undertook to approach Congress in those circumstances with a request for a further appropriation.

The new attitude to maintenance of value obligations left its impression on the Second Amendment of the Fund's Articles. A new financial structure was built, consisting of the General Resources Department and the Special Drawing Rights Department. The General Department consists of the General Resources Account (through which the traditional sales of currencies in exchange for the currency of the purchasing member are conducted), (92) the Special Disbursement Account (in which part of the proceeds of some sales of gold are held), (93) and the Investment Account (through which the Fund

(90) Pub. L. 95-435 (1978).

(91) Pub. L. 95-481 (1978), Title V.

(92) Article V, Section 2(a).

(93) Article V, Section 12(f).

can invest a certain amount of its assets). (94) The Fund can hold currencies in all three Accounts, but only the holdings in the General Resources Account must be maintained in value. The Fund has authority to administer resources held outside these Accounts, (95) but once again there is no obligation to maintain the value of these resources.

The absence of an obligation to maintain the value of currency holdings tends to be accompanied by authority to invest them, because investment may have the effect of maintaining value. The Fund is authorized, for example, to invest the currencies it holds in the Special Disbursement Account. (96)

The same tendencies can be observed in treaties other than the Articles of the Fund. The Agreements Establishing the International Fund for Agricultural Development and the Common Fund for Commodities are examples of such treaties. The International Cocoa Agreement, 1980 provides expressly that the investment of surplus funds is to be made in a manner that takes into account the desirability of « maintaining the real value of the funds. » (97)

The variability of exchange rates may not be the only motive for the decline of obligations to maintain value. Another motive may be the authority conferred on an international organization to exchange the currency it receives from a member for another currency. It may seem unreasonable to require the contributing member to go on maintaining the value of its contribution long after an exchange of currencies, and it may seem equally unreasonable to impose an obligation on the issuer of the currency into which the organization moves without any power of that country to veto the exchange.

AVERAGING EXCHANGE RATES

When it is necessary to prescribe the exchange rates that are to apply for the purpose of a treaty, the choice of the exchange rate for a single date may seem inequitable because of the fear that on any particular date the rate may be affected by temporary circumstances. A solution sometimes adopted is an averaging of exchange rates over a defined period. The motive may be not equity but the desirability of a more stable datum for a particular purpose so as to moderate the effects of day-to-day variations in exchange rates. Both

(94) Article XII, Section 6(f).

(95) Article V, Section 2(b).

(96) Article V, Section 12(h).

(97) Article 34.

motives may exist, but they can conflict with each other because averaging over a period in order to arrive at a stable datum may arrive at an exchange rate that is not representative of the current development of exchange rates.

The Convention on Civil Liability for Oil Pollution Damage Resulting from Offshore Operations, 1976 provides that the operator of an installation connected with the flow of crude oil or other products from the seabed or its subsoil may limit his liability for oil pollution. Liability is limited to specified amounts of SDRs translated into the currency of the contracting party in which the operator establishes a limitation fund. That fund is constituted on the basis of the average value of the currency in terms of the SDR, as published by the IMF, during the 30 days preceding the date on which the fund is constituted. (98)

The Rules of Procedure, 1976 of the Asian Clearing Union require the communication to all participants of the rate of exchange for each of their currencies in terms of the SDR. The rate is to hold good for an accounting period unless the rate is revised as the result of averaging. The formula for this purpose provides for averaging over a defined period the daily exchange rates between a participant's currency and the SDR arrived at by multiplying the middle of the spot buying and selling rates for the participant's intervention currency in terms of the SDR. (99)

The Detailed Regulations of the Convention of the Universal Postal Union (UPU), which are part of the legal instruments of that organization, were amended in the fall of 1979 as a consequence of the decision to adopt the SDR as the unit of account. A postal administration fixes postal charges in its currency in accordance with various legal instruments of the UPU and notifies the charges, in terms of the average value of the SDR, to the International Bureau for circulation to other postal administrations. The average is based on the daily values over a period of at least 12 months that ends on the preceding September 30, and this average value applies from the succeeding January 1 of each year. (100) This method was chosen in preference to other possible methods, including the application of values at the end of an accounting period or on some other single day.

Whatever the advantages of averaging may be in any particular instance, the solution undoubtedly runs the risk of applying a rate of exchange that does not reflect current conditions of a stable character. If averaging is applied to exchange rates in terms of a unit of account such as the SDR, the risk that an average may not be in accord with current conditions is not eliminated by providing for the settlement of obligations, calculated according to averaging, on the basis of the exchange rate in terms of the unit of account at the date of settlement. This practice is followed under the Detailed Regulations of the UPU. (101)

(98) Article VI, paragraph 11; *International Legal Materials,* Vol. XVI (1977), p. 1453.

(99) *Asian Basic Documents,* pp. 195-96.

(100) Article 104 as amended.

(101) Article 101 as amended.

Averaging, it will be seen later in this article, is a feature of the Guidelines for Decisions Under Article II : 6(a) of the General Agreement on Tariffs and Trade (GATT), but the Guidelines adopt a further technique in order to avoid action based on a depreciation that is temporary. Average effective exchange rates over a period of six months preceding a request for adjustment under the Guidelines are compared with average effective exchange rates over a period of six months preceding a reference date. A request for adjustment cannot be made for at least a year after the reference date, in order to have reasonable assurance that a depreciation is not temporary.

TOLERATED MARGINS OF VARIATION

The desire for a degree of stability in the exchange rate between a currency and a unit of account to be applied under a treaty, which has been mentioned in connection with averaging, is responsible sometimes for a provision that changes less than a certain amount are to be ignored for the purpose of the treaty. The stability mentioned here is in the operation of the treaty rather than in exchange rates.

The Rules of Procedure, 1976 of the Asian Clearing Union require the Managing Director to circulate to participants the exchange rate for their currencies for use in the operations of the Union. He is not required to make a new communication unless an exchange rate calculated in accordance with the prescribed formula varies by more than 1 1/8 per cent of the rate last communicated. (102)

Article II : 6(a) of the GATT, which is discussed in the next section, is another example of the desire for stability in the operation of a treaty. Under this provision, adjustments in binding specific duties were possible only if the par value of a currency was reduced by more than 20 per cent. The provision preceded the breakdown of the par value system, but the tolerated margin of variation has been retained in relation to the standard substituted for par values.

MEASUREMENT OF VARIATION

Treaties may make it necessary to measure for some purpose the extent to which the exchange rate for a currency has changed. The absence of a common denominator to which exchange rates must be related makes the problem of measurement more difficult than it was in the days of the par value system. This situation permits differences in the standard against which changes can be measured.

(102) *Asian Basic Documents*, pp. 196-97.

The Second Amendment of the Fund's Articles makes the measurement of change necessary for the purpose of maintaining the value of the Fund's holdings of currencies in the General Resources Account of the General Department. The SDR is the Fund's standard for this purpose. (103) The SDR can be regarded as a common denominator to that extent, but it is not one by which the external value of currencies must be regulated. A decision that gives operational effect to the standard for the limited purpose that it serves provides that the exchange rate for computations involving the currency of a member in the General Resources Account is to be the rate that prevailed three business days before the value date of an operation or transaction between the Fund and another member, and in all other computations the exchange rate corresponds to the rate on the basis of which the Fund already holds the currency. The effect of the decision is that if the exchange rate between two currencies is involved, an exchange rate close to the value date of the operation or transaction is applied, but no pressing need to apply a current exchange rate exists if the only interest involved is that of the member issuing a currency. The current exchange rate for the currency can be the basis for computation at some other date, for example at the end of the Fund's financial year.

When it becomes necessary to apply a current rate of exchange for a currency, an adjustment is made, on the basis of that exchange rate, of all the Fund's holdings of the currency in the General Resources Account. The amount of the adjustment is entered in an account receivable or account payable, as the case may be. A similar adjustment is made of any amount in such an account that is the consequence of earlier adjustments. Settlements of these accounts are made at appointed dates. The effect of this technique is to measure the movement in the exchange rate for a currency in terms of the SDR as compared with the exchange rate on the basis of which the Fund is holding the currency before adjustment. The measurement produces an entry in an account receivable if there is depreciation compared with the latter exchange rate and an entry in an account payable if there is an appreciation. (104)

The « divergence indicator » of the EMS, which is discussed later, is another technique for measuring movements in exchange rates. The standard against which movements are measured is the ECU. The purpose of measurement is to determine *prima facie* which participant in the exchange rate and intervention arrangements (ERIA) of the EMS should take action to remedy the divergence. The ECU, however, has a broader function than its service as a standard of measurement. It serves also as the common denominator in terms of which participants in the ERIA define the external value of their currencies and undertake obligations based on the parities resulting from

(103) Article V, Sections 10 and 11.

(104) Decision No. 5590-(77/163), December 1, 1977, effective April 1, 1978. *(Selected Decisions of the International Monetary Fund and Selected Documents, Supplement to Eighth Issue* (Washington, D.C., 1978) (hereinafter referred to as *Selected Decisions, Supplement*), pp. 47-48.

that definition. The ECU as common denominator is not universal but it is imposed as an international norm governing exchange rates and, in this aspect, can be distinguished from the SDR. Some members peg their currencies to the SDR but not as the result of agreement among themeselves or of any other obligation. Moreover, the peg to the SDR does not create obligations, while the peg to the ECU does have this effect under the ERIA of the EMS.

The most intensive examination of the problem of measuring the movement of exchange rates for the purposes of a treaty has been made in connection with Article II : 6(a) of the General Agreement on Tariffs and Trade (GATT). Tariff « concessions » under the GATT, resulting in « bound » tariffs, are commitments by a contracting party to levy no more than a stated tariff on a particular item. If the tariff takes the form of a specific duty, which is expressed as a fixed amount for a physical unit of an import, the level of effective, or *ad valorem,* rate of protection it affords to an importing country is eroded with a depreciation of its currency because of the upward change in the value of the import in terms of the currency. Countries might be reluctant to enter into binding specific duties in tariff negotiations if they were unable to adjust the duties in such circumstances.

Article II : 6(a) was intended to provide a remedy. Specific duties were expressed in currencies at par values accepted or provisionally recognized by the Fund. If such a par value was reduced by more than 20 per cent consistently with the Fund's Articles, the specific duties could be adjusted to take care of the devaluation, subject to certain safeguards. The abrogation of the par value system did not dispose of the difficulty that the provision was intended to solve, but the problem was how to measure a depreciation in the absence of an internationally accepted common denominator for currencies. The GATT Council of Representatives established a Working Party on Specific Duty Adjustments to examine the problem and to consult with the Fund for this purpose.

A study by the staff of the Fund examined a variety of possible denominators in terms of which a decline in the external value of a currency could be measured, including the U.S. dollar, another currency, the SDR, or some other basket of currencies. The staff concluded that all these denominators were unsatisfactory in one way or another for the purpose of Article II : 6(a).

It may seem surprising that the choice of the SDR was not endorsed. Some of the objections to it as a solution will be mentioned. First, a growing number of currencies are pegged to the SDR, with the result that no change would occur in the calculated external value of such a currency except when the peg was changed. Second, if the currency for which a calculation was being made was in the SDR basket, a distortion would be introduced into the calculation. Third, the imports of a country would be unlikely to correspond to the weights in the SDR basket, with the consequence that the SDR would not be a standard by which to measure the decline in the protective effect of specifie duties on imports that resulted from depreciation.

The solution recommended by the study was an index for a country's currency based on each of the countries from which the country imports, with weights in the index proportioned to the shares of each exporting country in the importing country's total imports. Even this solution is not perfect because the « effective exchange rate » (105) that it yields measures changes in the unit price of all imports in terms of the importing country's currency and not the changes in the unit price of those imports on which specific duties are to be adjusted, but other methods of measurement are subject to similar disadvantages.

The GATT Council of Representatives approved Guidelines for decisions by the CONTRACTING PARTIES as recommended by the Working Party. (106) The Guidelines are based on the concept of the effective exchange rate. The Fund is asked to calculate the size of a depreciation according to this concept and the consistency of the depreciation with the Articles. The Fund's calculation is to be based on a comparison between the average effective exchange rate over a period of six months preceding an applicant country's request for adjustment with the average effective exchange rate during the six months preceding the date of the last binding of the specific duties or of the last authorization of an adjustment of them, whichever is later. Normally, in the interests of accuracy, the calculation should be based on the currencies of trading partners supplying at least 80 per cent of the imports of the applicant country.

If a contracting party expresses its specific duties in terms of a unit other than its currency, such as one or more other currencies or an international unit of account, depreciation is measured in terms of the chosen unit. If contracting parties belong to a customs union and define their common specific duties in terms of a unit of account composed of the currencies of the members, the depreciation is taken to be the average depreciation of the unit of account in terms of the currencies of « third » countries, each weighted by its share in the total imports of the customs union.

The CONTRACTING PARTIES are deemed to have authorized the adjustment requested by an applicant once the Fund confirms that the depreciation is in excess of 20 per cent and is consistent with the Fund's Articles, provided that no contracting party protests within 60 days. If there is a protest, procedures are followed for arriving at a decision.

The solution incorporated in the Guidelines may be appropriate under other treaties. The CONTRACTING PARTIES have arrived at the solution without amendment of the GATT, which would have required acceptance by all contracting parties. (107) This pragmatism is reminiscent of the practices

(105) On the efforts of economists to arrive at effective exchange rates, see the bibliography at pp. 98-99 attached to Leslie Lipschitz and V. Sundararajan, « The Optimal Basket in a World of Generalized Floating », IMF *Staff Papers,* Vol. 27 (1980), pp. 80-99.

(106) GATT Document L/4938, February 15, 1980.

(107) Article XXX : 1 (GATT).

followed by the administrators of other treaties in concluding by interpretation or executive decision that in current conditions the SDR must be substituted for gold as the unit of account under their treaties. It is reminiscent also of the decision of the Fund in 1974, before the Second Amendment, that the gold value of the SDR would have to be attributed to a basket of 16 currencies.

VALUATION

Valuation for international purposes may require the translation of one currency into another. Methods of valuation for customs purposes can be serious impediments to international trade. (108) Article VII of the GATT provided that when it was necessary for a contracting party to translate into its own currency a price expressed in the currency of another country, the primary rule was that this calculation was to be based, for each currency involved, on the par value established under the Fund's Articles or on the rate of exchange recognized by the Fund.

This primary rule ceased to be applicable with the breakdown of the par value system. (109) The problem was considered as part of the Tokyo Round of Multilateral Trade Negotiations. The solution was included in the Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade and Protocol. Article 9 of this Agreement provides that when the calculation referred to above is necessary, the rate of exchange shall be the one duly pulished by the competent authorities of the country of importation and shall reflect as effectively as possible, in respect of the period covered by each such published document, the current value of the currency in commercial transactions in terms of the currency of importation. The date for the choice of the rate of exchange is to be the one in effect at the time of exportation or the time of importation.

A problem of valuation had to be settled for the purposes of the EMS. Participants in the ERIA must, and nonparticipants may, contribute 20 per cent of their gold and gross U.S. dollar holdings to the European Monetary Co-operation Fund (EMCF) in return for ECUs under revolving swaps of 3 months in duration. On the renewal of these swaps, adjustments must be made to ensure that the contribution continues to conform with this norm notwithstanding changes that have occurred in a member's reserve position or in the price of gold or in exchange rates for the U.S. dollar. The exchange

(108) Report by the Director-General of GATT, *The Tokyo Round of Multilateral Trade Negotiations* (Geneva, April 1979), pp. 68-74.

(109) « The rate of exchange recognized by the Fund » might have been deemed to be either the « representative rate » determined by the Fund in consultation with each member for certain purposes (see Rule 0-2, Rules and Regulations, 37th Issue, January 1, 1981) or the rate of exchange on the basis of which the Fund holds a member's currency in accordance with Article IV, Section 11. It is possible, however, that neither of these rates of exchange would have maximum effectiveness in promoting the policy of the Agreement on customs valuation.

rate for this purpose is the one that prevailed in the market two working days prior to the value date for the adjustment. (110)

THE EUROPEAN MONETARY SYSTEM

One of the reactions of outstanding importance to the variability of exchange rates has been the creation of the European Monetary System. One of the main forces that led to the EMS was the policy of the United States in not managing the exchange rate for the U.S. dollar. Fluctuations in the exchange rate for the dollar induced many holders of that currency to move into the deutsche mark, which affected the exchange rate of that currency with other Community currencies, even when those effects were not justified by underlying conditions. The exports of the Federal Republic tended to become less competitive in Community markets. Intervention by the Bundesbank in the exchange market to moderate appreciation inflated the money supply.

The volatility of exchange rates had adverse effects on growth and employment and threatened intra-Community trade, which was more than half the foreign trade of members of the Community and substantially more for some of them. The integration that had been achieved already seemed to be threatened. Stable relationships among the currencies of the Community were desirable under arrangements that would be broader than those of the agreement on common margins (the « snake »).

To counteract these disadvantages and dangers, and in the hope that political as well as monetary integration would be promoted, the Bremen Communiqué was issued after the meeting of the European Council, composed of the Heads of State and Government of the Community countries, on July 6 and 7, 1978. The Communiqué endorsed the idea of a « scheme for the creation of closer monetary co-operation leading to a zone of monetary stability in Europe ». « Stability » is not a comfortable word, because changes in exchange rates are not forbidden but whatever may be the precise meaning attributed to the word, a greater degree of legal order and a lesser degree of fluctuation in exchange rates are obvious aspirations of the Communiqué.

As for the specific problem of movements out of the U.S. dollar and into the deutsche mark, the effect of a zone of monetary stability based on ties among Community currencies could be that the strain of these movements would be borne by the bloc as a whole and not by the deutsche mark alone.

The legal instruments of the EMS are a complex of agreements among the central banks of members of the Community, decisions of the Board of Governors of the EMCF, and resolutions and regulations of the European

(110) Committee of Governors of the Central Banks of the Member States of the European Economic Community; European Monetary Cooperation Fund : *Texts concerning the European Monetary System* (1979) (hereinafter referred to as *Texts concerning the European Monetary System*), pp. 15-16.

Council. (111) One of the main instruments in this complex, the Resolution of the European Council of December 5, 1978 on the establishment of the European Monetary System (EMS) and related matters, (112) has been characterized by the Constitutional Council of France as a political declaration (*une déclaration de caractère politique*). (113) If « political » means nonlegal, it is difficult to agree with this analysis. The only finding that appears to have been necessary for decision of the issue before the Constitutional Council was that the Resolution was not an international treaty or agreement (*un traité ou accord international ayant par lui-même des effets juridiques*).

The complex of legal instruments, it will be noted, include agreements among central banks. Moreover, it has been pointed out that some of the commitments entered into do not formally rely on the Treaty of Rome. (114) According to traditional thinking, agreements among central banks are not treaties, but no satisfactory classification exists of this form of official consensual arrangement. The classification of these arrangements cannot ignore the role they play in the political economy of nations or the use made of them by political authorities to avoid the necessity for consensual arrangements that are unambiguously international agreements.

All members of the Community are members of the EMS, but the United Kingdom has chosen not to participate so far in the ERIA. Greece, which entered the Community recently, has not yet announced its decision. The first stage of the EMS, which was to last for two years and to be followed by a final and more ambitious plan involving a European Monetary Fund with broad powers, has been prolonged, but without abandoning the intention to proceed to a final plan. (115) Political considerations have been the main reason for delay, but legal difficulties also have been a contributory cause.

The ECU functions as the common denominator for the exchange arrangements, the basis for calculating the « divergence indicator », the unit of account for the intervention arrangements and the credit transactions of the EMCF, and a means of settlement among the monetary authorities of members. The amounts of currencies in the ECU may be revised if the percentage of any currency, based on exchange rates, has changed by 25 per cent or more and a review is requested. Revisions have to be « mutually accepted. » (116)

(111) See *The European Monetary System : Problems and Prospects,* A Study prepared for the use of the Subcommittee on International Economics, etc., 96th U.S. Congress, 1st Session, November 1979, and Jean-Jacques Rey, « The European Monetary System », *Common Market Law Review,* Feb. 1980, pp. 7-30.

(112) *Texts concerning the European Monetary System,* pp. 43-50.

(113) *Journal du Droit International,* No. 1 (1979), pp. 709-85.

(114) See Rey (*supra,* footnote 111), pp. 29, 30. See also Michael H. Ryan, « The Treaty of Rome and Monetary Policy in the European Community, » *Ottawa Law Review,* Vol. 10 (1978), pp. 534-65.

(115) Communiqué of European Council, Luxembourg, December 1 and 2, 1980.

(116) *Texts concerning the European Monetary System,* p. 44.

A central rate is established in terms of the ECU for each participant's currency. A grid of parities among all these currencies is formed as a consequence of central rates. Margins of 2.25 per cent above and below parity must be observed by participants in the ERIA as limits for exchange transactions. Italy has taken advantage of a provision that permits margins of 6 per cent, provided that they are reduced gradually. Central rates in terms of the ECU can be adjusted by « mutual agreement by a common procedure. » (117)

Intervention at the boundary of the margins around bilateral parities is obligatory. Intervention within the margins is not precluded and may be appropriate if the divergence indicator gives a signal or in other circumstances. The divergence indicator gives a warning if the market rate of a currency crosses its divergence threshold, which is calculated for a currency as follows :

> 0.75 × 2.25 (or 6 per cent for Italy) × (1 minus the weight of the currency in the ECU basket).

A currency crosses its divergence threshold whenever the market rate of a currency deviates from its central rate in terms of the ECU by more than 75 per cent of the deviation from the central rate that would occur if the currency were at its upper or lower intervention limit against all other currencies in the ECU simultaneously. In this calculation, margins of 2.25 per cent are assumed for the Italian lira and the pound sterling. If the currency of a participant in the ERIA crosses its divergence threshold, it is diverging from the Community average, and a presumption, although not an obligation, arises that it will « correct this situation by adequate measures. » (118) The measures include intervention in diverse currencies, domestic monetary policy measures, changes in central rates, or other measures of economic policy. If, because of «special circumstances, » corrective measures are not taken, the reasons must be explained to other participants in the ERIA. (119)

Reciprocal lines of credit of unlimited amount are established for financing intervention. Settlements are made after a brief interval, subject to postponements that may be made by debtors as of right or with the consent of creditors. Settlements take place wholly or partly in ECUs.

Stability among the currencies of participants in the ERIA is regulated with some precision by means of the arrangements as described briefly above, but stability in relation to other currencies is a less closely regulated objective. It is recognized that « the durability of the EMS and its international implications require co-ordination of exchange rate policies vis-à-vis third currencies and, as far as possible, a concertation with the monetary authorities of those counties. » (120) Harmonized policy on intervention in

(117) *Ibid.,* p. 44.
(118) *Ibid.,* p. 45.
(119) *Ibid.,* p. 45.
(120) *Ibid.,* pp. 46-47.

U.S. dollars is probably part of the coordination that is foreseen. Furthermore, European countries with particularly close economic and financial ties with the Community may participate in the ERIA under agreements entered into by central banks.

SOME CONCLUDING REFLECTIONS

The breakdown of the par value system and the failure of members of the Fund to agree on a comparable substitute for it based on a common denominator produce manifold problems for the negotiators of new treaties and the amendment of existing treaties. Many problems have been examined in this article, but there may be others. The negotiators have wanted to control the variability of exchange rates or they have wanted to deal with the consequences of variability. These developments can be seen as support for the view of some experts, both official and nonofficial, that since the breakdown of the par value system there are international monetary arrangements but no international monetary system.

The variability of exchange rates has contributed to emergence of the EMS as the foundation of a zone of monetary stability. The word « system » in the title has an intended resonance. Opinions differ on the success achieved so far, but opinions vary less on the potential importance, both monetary and political, of this development. (121)

Some of the technical features have an interest that is not confined to the Community. The divergence indicator, for example, is a technique for recognizing which currency has moved in relation to an agreed standard and for measuring the extent of the movement. Since the days when the Committee of the Fund's Board of Governors on Reform of the International Monetary System and Related Issues was discussing exchange arrangements, techniques of this kind have been known as objective indicators. Their original *raison d'être* was to point to the countries that should take action, or be subjected to pressures if they failed to do so, because of movements in the exchange rates for their currencies. So far, only the divergence indicator has been adopted by international agreement for a comparable purpose, although the Fund's decision on surveillance over the exchange rate policies of its members lists certain developments that might be *prima facie* evidence of the need for special consultation with a member. (122) These latter developments, however, are not objective in the sense in which the expression « objective indicators » is used, because judgment is required in order to decide whether the developments have occurred.

(121) Tom de Vries, *On the Meaning and Future of the European Monetary System,* Essays in International Finance, No. 138 (Princeton, New Jersey, September 1980).

(122) *Selected Decisions, Supplement,* pp. 5-10.

The negotiators of treaties or of amendments tend to follow earlier legal solutions that have been found for the consequences of exchange rate variability, but there is also a tendency to improve on earlier solutions. The more polished provisions on the unit of account in the Hamburg Rules when compared with the Montreal Protocols are an example of an improved solution. The advice of observers from the Fund has contributed to improvements in the drafting of financial provisions. Expert advice is desirable, and even essential, because often monetary problems arise in the negotiation of treaties that are not fundamentally financial. The negotiators are expert on the fundamental project but not on the monetary problems, which nevertheless must be solved satisfactorily.

There are, however, few requirements in recent treaties or amendments of consultation with the Fund on the administration of provisions involving exchange rates. The explanation may be the reluctance of nonmembers of the Fund participating in the negotiation of the treaty or amendment to see explicit references to advice by the Fund. Nonmembers have no part in the deliberations of the Fund and no voting power when it takes decisions. Silence in the treaty, however, does not preclude approaches to the Fund for consultation on exchange rate matters. The realization that these approaches are possible may help to explain the silence.

One of the most prominent problems affected by the participation of nonmembers of the Fund in the negotiation of treaties has been the choice of the unit of account. Nevertheless, the ever-increasing choice of the SDR has reduced the severity of this problem.