CHAPTER

1 Current Legal Aspects of Monetary Sovereignty

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In press articles and ministerial communiqués, the International Monetary Fund (IMF) is often listed among international financial institutions. Actually, the primary function of the IMF is not to provide financial assistance to its members but to attain certain objectives in international monetary relations. It is first and foremost a monetary institution.

To achieve its objectives in international monetary relations (essentially exchange rate stability and liberalization of payments and transfers for current international transactions), the IMF can use different instruments. One of them is the provision of financial assistance for balance of payments problems. By making foreign exchange available to its members in times of crisis, the IMF provides "them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity."[1] Another instrument is of a regulatory rather than financial nature: the IMF monitors the compliance by its members with certain obligations specified in the Articles of Agreement. These obligations constitute a code of good monetary conduct that IMF members are required to observe.

By joining the membership of the IMF, the members have accepted these obligations and, to that extent, limited their monetary sovereignty. In exchange, they have received certain benefits. One of them is that other members too have agreed to limit their sovereignty for the sake of international cooperation and for the common good of all. Another benefit is that in times of crisis they will have access to financial assistance from the IMF if they meet the required conditions.

As most countries are now members of the IMF, it may be said that full monetary sovereignty exists only in those few countries that are not members of the IMF. In addition to being members of the IMF, some countries are members of regional monetary unions that have limited their monetary sovereignty even beyond the limitations imposed by the IMF's Articles. For instance, in the European Monetary Union, a common currency has replaced the national currencies. Similarly, the West African and the Central African Monetary Unions have their respective common currencies; the member states do not issue separate national currencies. These African unions are even more integrated than the European Monetary Union; for example, they have no national central banks, and they have a common system of exchange controls for their financial relations with countries outside each union. Accordingly, there are today different levels of monetary sovereignty.

This chapter examines the different components of monetary sovereignty and assesses the extent to which these components have or have not been restricted by rules of international law. One of the issues to be addressed will be the issue of conflicts of sovereignty. As sovereign countries are equal subjects of international law, the sovereignty of one cannot infringe on the sovereignty of another. In practice, however, it is not always easy to know where the sovereignty of one ends and the sovereignty of another begins.

Monetary sovereignty includes essentially three exclusive rights for a given state:[2]

- the right to issue currency, that is, coins and banknotes that are legal tender within its territory;[3]
- the right to determine and change the value of that currency; and
- the right to regulate the use of that currency, or any other currency, within its territory.

The first and third rights correspond to the role of money as a medium of payment. The second right reflects the role of money as a unit of account. Conceptually, the two functions may be separated: a monetary unit of account may be represented by coins and notes bearing a different name (e.g., in France before the Revolution,[4] and recently in the European Monetary Union during the interim period after the euro became the official currency and while national currencies were still being used).

Moreover, for purposes of the third right (use of currency), the concept of currency is usually expanded to cover not only coins and banknotes denominated in local or foreign currency but also other means of payment denominated in any currency (essentially, bank balances).

The Issuance of Currency

Principles

The right to issue currency in a territory may be exercised by the state that has sovereignty over the territory; it may be delegated to a central bank or other entity (e.g., currency board); several states may delegate their power to issue currency to a common central bank (e.g., the Central Bank of West African States, the European Central Bank, etc.).

In the exercise of its monetary sovereignty, a state may determine the name of its currency and the face value and physical features of the banknotes and coins denominated in that currency. It may also decide to issue a new currency, which will then require a determination of a rate of conversion from the old currency to the new one.[5]

The right to issue currency has economic implications that go far beyond the supply of coins and banknotes to a country's economy. A central bank vested with the exclusive power to issue currency within a given territory may extend credit to operators within that territory, in particular commercial banks, which will use it to finance their own activities, including by extending credit to their own customers. Through the opening of lines of credit or rediscount facilities or open market operations, the central bank will regulate the volume and cost of credit, if not directly, at least indirectly, within that territory. These operations will usually not result in the issuance of coins and banknotes but mainly in book entries; however, the effect on the economy will be the same, because claims in the books of the central bank can be converted into currency. The central bank's right to issue currency allows it to conduct the country's monetary policy.

A state's right to issue its currency is protected against foreign states. Counterfeiting another state's currency would be seen as an infringement of its sovereignty. Therefore, a state may not counterfeit another state's currency.[6]

Exceptions

Does the prohibition against counterfeiting another state's currency apply in times of war? There have been instances of such practices.[7]

In the case of belligerent occupation, it is common practice for the occupant to use its own currency or local currency for payments to local residents. A more difficult question is whether the Hague Regulations of 1907, which apply in situations of belligerent occupations, implicitly prohibit the occupying state from changing the currency of the occupied country. In post-war Germany, the Allied Powers replaced the reichsmark by the deutsche mark; one argument was that the Hague Regulations did not apply because Germany had disappeared as a sovereign state. During the occupation of Iraq in 2003, a new currency was issued by the central bank of Iraq pursuant to a regulation enacted by the Coalition Provisional Authority; however, Iraq was still regarded as a sovereign state—it had lost only the exercise of its sovereignty (absence of an internationally recognized government), and the United Nations (UN) Security Council had recognized the applicability of the Hague Regulations in Iraq during the occupation.[8] The introduction of a new currency is not per se a violation of the Hague Regulations because a belligerent occupant may take economic measures for the public good of the occupied country. The legality of that measure will depend on whether it was actually taken for that public good and in particular on whether or not it was of a confiscatory nature.[9]

The Valuation of Currency

Principles

The state that issues a currency may determine and change the value of that currency. It is also free not to determine a particular value for its currency (e.g., in terms of other currencies).

A delegation by a state to a central bank or other entity of the right to issue currency does not necessarily confer the right to determine and change the value of the currency. This right may be retained by the state.

Under the par value system of the IMF's original Articles of Agreement, the par value of a member's currency was determined in terms of gold, which created an obligation for the member to maintain exchange rates within specified margins around parity; the parity was the relationship between any two currencies based on their respective par values. The par value could be changed unilaterally by the member. Beyond a threshold, the IMF's concurrence for a change had to be sought. If it were refused and the par value was nevertheless changed (e.g., in the case of France in 1948), the member became ineligible to use the IMF's resources, but the change was not regarded as a breach of obligation under the IMF's Articles. Sovereignty was recognized even in that case.

Since a change in the value of a currency is not a breach of international law, a state is not liable for its consequences on holders of its currency, or on creditors or debtors that have claims or obligations denominated in that currency.[10] The issue has arisen in cases of devaluation;[11] it could equally arise in cases of revaluation. There could be an exception to this rule if the state "pursues a deliberate course of injuring or discriminating against foreigners."[12]

The right to change the value of the currency is sometimes understood as conferring the right to prohibit maintenance of value clauses (e.g., gold clauses).

Exceptions

Under the present Articles of Agreement of the IMF, there are certain limitations on the members' right to determine or change the value of their currency:

- a member may not determine the value of its currency in terms of gold; any other valuation is permitted, but none is required (i.e., a member may decide to let its currency float);[13]

- a member may not manipulate exchange rates in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members;[14] and
- a member may not engage in multiple currency practices[15] (e.g., broken cross rates).

Extraterritorial Effects

Extraterritorial effects of legislation may be understood in two different ways. Under the first meaning, a country decides that its laws will apply to (and its courts will have jurisdiction over) acts occurring outside its territory. In the "Lotus" case,[16] the Permanent Court of International Justice held that, in principle and subject to limited exceptions under international law, a state could exercise its jurisdiction, through legislative and judicial action, to facts occurring outside its territory (e.g., outside its territorial waters).

Under a second meaning, a law has extraterritorial effects if the courts of other states are required under international law to give effect to that law. In principle, and subject to certain exceptions (e.g., under international treaties), there is no such obligation. It is for the private international law of the forum (i.e., the national law of the court exercising jurisdiction over the case) to determine the applicability of foreign laws by its courts.

When the case is decided by an international court, it will look to generally accepted principles of private international law for a solution to the choice of law issue. For instance, in the Serbian and Brazilian loans cases in 1929,[17] the Permanent Court of International Justice, while recognizing that the *lex monetae* determines the value of the currency, held that the effects of a devaluation on a contract raised questions of private international law and that it was eventually for the *lex contractus* to determine the effects of a devaluation on the contract.

International law allows each state to change the value of its currency. In general, the principle known as nominalism will lead to a recognition abroad that a devaluation or revaluation operated by the *lex monetae* affects the value of obligations denominated in that currency, but there may be exceptions. The most common issue is whether the parties to a contract have implicitly or explicitly agreed that their obligations would not be affected by such changes, for instance, by inserting a maintenance of value clause in terms of another currency or gold. In such cases, the extent to which the devaluation or revaluation is given effect by a foreign court will depend on the rules of private international law of the forum (i.e., *lex contractus*, public policy of the forum (*ordre public*), or other rules).

In the 1950 decision in *Messageries Maritimes*, a case involving bonds issued in Canada by a French company and denominated in Canadian gold dollars, the French *Cour de cassation* refused to give effect to a Canadian law devaluing the Canadian dollar and avoiding gold clauses in existing contracts on the grounds that, as a matter of *ordre public* and notwithstanding the mandatory provisions of the law governing the contract, rules of French law on international contracts did not allow the court to recognize the effect of foreign monetary laws on international contracts.[18] In a subsequent development of that case, a further decision of the Cour de cassation on October 29, 1964 reached the same result, this time on the grounds that French law was the *lex contractus*.[19]

The replacement of an old currency by a new currency raises similar issues. Foreign courts will usually recognize the conversion of obligations denominated in the old currency into obligations denominated in the new currency. The continuity of contracts will not be affected. In some cases, however, legislation has been passed to dispel any doubt on this outcome. For example, this issue arose in the United States after the European Union's (EU's) decision to substitute the European Currency Unit (ECU) with the euro at a rate of one to one, and, on the basis of that rate, to gradually substitute the euro for the national currencies of the members of the European Monetary Union (EMU), which were previously valued in terms of the ECU. New York and some other states decided to enact legislation to recognize the rate of conversion from ECU to euro and the substitution of the euro for the EMU members' currencies. It was an unprecedented action, due to the concern that some market participants might initiate litigation to challenge, if not the change itself, at least its application to their contracts.[20]

The right to regulate maintenance of value clauses is not really an attribute of the right to change the value of the currency. It applies regardless of the currency being used as the unit of account. The European Council's regulation of June 17, 1997, substituting the ECU with the euro recognized the validity of such clauses as a possible exception to the official 1 ECU = 1 euro rate of conversion.

The question in practice is what law governs maintenance of value clauses in international contracts. In the Norwegian loans case,[21] the International Court of Justice applied Norwegian law as the *lex contractus* to gold clauses in loans issued by Norway, thus allowing the sovereign debtor to release itself from its contractual obligations by amending its own laws. Clearly, this creates an incentive for creditors not to agree to the application of the sovereign debtor's laws to their contracts. In the Serbian and Brazilian loans cases,[22] the sovereign debtor's law was not the *lex contractus*. French law was applied as the *lex contractus*, thus validating the gold clause, notwithstanding the fact that French law was also the *lex monetae* and was the cause of the devaluation of the currency in which the loans were denominated. The Court found that the rule under French law was that maintenance of value clauses were always valid in international contracts, and that was the rule applied by the Court.

The Use of Currency

Principles

A state may regulate the use of its currency and of other currencies within its territory. It may regulate payments, impose exchange controls, prohibit the making or receipt of payments and transfers in foreign currency for domestic and international transactions, and so forth. It may limit the scope of legal tender, for example, by requiring that payments above a certain amount be made by checks or transfers (to avoid tax evasion).

The regulation of currency includes all means of payment (including bank balances) denominated in that currency.

Exceptions

Exchange restrictions imposed by one state have an adverse effect on cross-border transactions and, thus, on the interests of other states. Therefore, various international treaties limit the parties' right to restrict international payments and transfers (EU, Organization For Economic Cooperation and Development (OECD), World Trade Organization (WTO), IMF). Under the IMF Articles, members may restrict capital movements but need IMF approval for restrictions on the making of payments and transfers for current international transactions.[23] The OECD has adopted two codes of liberalization for its members: one for current invisible operations and the other for capital movements. The EU has liberalized current and capital movements. The treaties administered by the WTO (the General Agreement on Tariffs and Trade and the General Agreement on Trade in Services) also contain rules on liberalization of exchange restrictions.

Conversely, there may be instances in which a state is under an international obligation to impose trade and/or exchange restrictions against another country. This is the case when the UN Security Council, acting under Chapter VII of the UN Charter, requires UN members to impose economic sanctions that include exchange restrictions (Article 41 of the UN Charter).[24] States imposing exchange restrictions pursuant to a Security Council resolution must notify the IMF of the restrictions if they are subject to IMF approval (i.e., restrictions on the making of payments or transfers for current international transactions).[25] Faced with the threat of international terrorism, the UN Security Council has now adopted a broader interpretation of its powers under Chapter VII of the UN Charter. It has decided to impose economic sanctions not only against states but also against individuals and entities (terrorists and terrorist organizations) for the preservation of peace.[26] See, for instance, Resolutions No. 1267 (1999)[27] and 1333 (2000)[28] concerning the Taliban, 1373 (2001)[29] on the prevention and suppression of the financing of terrorists acts, and 1390 (2002)[30] and 1526 (2004)[31] on Al-Qaida and the Taliban. These sanctions usually include freezes of assets and other restrictions.

Extraterritorial Effects

A state may prohibit the use of its currency abroad, for example, by persons under its jurisdiction, or more generally any use of its currency for payments abroad. There seems to have been no example of a state requiring the use of its currency abroad, except in cases of occupation of a foreign territory.

Whether other states must recognize the extraterritorial effect of such laws or more generally give effect to the laws of a foreign state on the use of its currency raises difficult questions.[32]

(1) The recognition of another state's exchange controls may be based on the forum's principles of private international law (*lex loci solutionis*, *lex contractus*, Article 7 of the Rome Convention on contractual obligations, act of state doctrine, comity), but the counter-argument in some countries is that foreign public laws are not to be given effect, even to the extent that they affect only contractual obligations. Article VIII, Section 2(*b*) of the IMF Articles imposes a limited obligation of cooperation against violations of other countries' exchange controls. However, the restrictive interpretation of that provision in major financial centers (New York, London) and its non-application to capital transfers in Germany show the reluctance of national courts to recognize other countries' exchange controls.[33]

(2) The obligation of cooperation imposed by Article VIII, Section 2(*b*) is generally seen as an exception to general principles of public international law. Otherwise, there would be no need for it in an international treaty. Nevertheless, some have argued that a country's regulation of the use of its own currency abroad is an attribute of its sovereignty and must be recognized by foreign countries as a general principle of public international law.[34] This principle would not only make Article VIII, Section 2(*b*) superfluous but also impose obligations exceeding the scope of that provision. The consequences would be particularly important for those countries whose national courts have taken a restrictive interpretation of Article VIII, Section 2(*b*). In practice, however, there is no evidence that such a far-reaching obligation has been recognized as a consequence of the monetary sovereignty of other countries, even in cases where the extraterritorial application of the *lex monetae* was also based on personal jurisdiction over one of the parties to the contract. This dual jurisdictional basis was used in U.S. freezes of official Iranian and, later, Libyan assets, which have both given rise to litigation. U.S. jurisdiction was based on both the use of the U.S. dollar and the U.S. nationality of the banks in which the deposits were held outside the United States. In 1989, in the *Bankers' Trust* case, the English judge refused to give effect to the U.S. freeze over official Libyan assets deposited in a U.K. branch of a U.S. bank.[35]

(3) A related question is whether the issuer of a currency may object to the use of that currency as legal tender abroad, or as unit of account for deposits in foreign banks, by insisting that its currency not be used for such purposes without its consent. Again, a state may enact legislation, or make representations to other states, to that effect, but there would be no obligation for foreign states or their national courts to give effect to such laws or representations as an extraterritorial attribute of that state's sovereignty. The territorial sovereignty of the state of the forum would take precedence.[36]

Conclusion

Through customary law, doctrinal sources, judicial decisions, and treaties, a body of international law has been developed that defines the contours of monetary sovereignty. Its attributes have been identified and limitations have been introduced. The remaining issues are essentially related to the extraterritorial effects of monetary sovereignty. With respect to those effects, there have been attempts to expand the scope of public international law for a recognition of the *lex monetae* beyond the issuer's territory. Clearly, these extraterritorial effects are in conflict with the sovereignty of other states. Absent a rule of international law requiring a state to give effect to a foreign state's *lex monetae*, the principle is that it may refuse to give it any effect. This will be a matter to be decided in accordance with the private international law of the forum.

Notes

[1] IMF, *Articles of Agreement of the International Monetary Fund*, Article I(v), http://www/imf.org/external/pubs/ft/aa/index/htm.

[2] On the attributes of monetary sovereignty, see F.A. Mann, *The Legal Aspect of Money*, 5th edition (Oxford: Clarendon Press, 1992), at 460–78; D. Carreau, *Souveraineté et coopération monétaire internationale* (Paris: LGDJ, 1970), at 15–97; G. Burdeau, "L'exercice des compétences monétaires par les Etats," *Academy of International Law, Recueil des cours* (1988-V), at 223–49.

[3] On the distinction between currency (as legal tender) and "private money" (including "electronic money"), see M. Laine, "La monnaie privée," *Revue Trimestrielle de Droit Commercial et de Droit Economique*, 2004, at 227.

[4] "Livre," "sou," and "denier" were units of account. "Franc," "louis," and "écu" were gold or silver coins. The relationship between the units of account and the coins varied over time, as did the gold or silver content of the coins. For instance, in May 1726, the value of the gold louis was raised from 20 to 24 livres and the silver écu from 5 to 6 livres; *see* R. Sédillot, *Le Franc, Histoire d'une monnaie des origines à nos jours* (Paris: Sirey, 1953), at 77. Initially a gold coin, the franc became a silver coin in the sixteenth century; until 1602, 1 franc was worth 1 livre, and the two terms could be used as synonyms.

[5] *See infra* the section entitled "The Valuation of Currency."

[6] This is according to customary international law and the Geneva Convention of April 20, 1929, for the Suppression of Counterfeiting Currency.

[7] *See* Mann, *supra* note 2, at 481.

[8] Resolution 1483, op. para. 5, UN SCOR, 58th Sess., 4761st mtg. UN Doc. S/RES/1483 (2003).

[9] On the various options offered to a belligerent occupant, see Mann, *supra* note 2, at 481–87.

[10] *See* Mann, *supra* note 2, at 464.

[11] U.S. Foreign Claims Settlement Commission, Zuk Claim, November 5, 1956, *International Law Reports*, Vol. 26 (1958-II), at 284; H. Booysen, "Devaluation as an Exercise of Monetary Sovereignty and a Basis for State Liability," *South African Yearbook of International Law*, Vol. 18 (1992–93), at 89–104.

[12] *See* U.S. Foreign Claims Settlement Commission, Zuk Claim, November 5, 1956, *International Law Report*, Vol. 26 (1958-II), at 285. For other examples, see Mann, *supra* note 2, at 469–71.

[13] IMF, *Articles of Agreement of the International Monetary Fund*, Article IV, Section 2(*b*), http://www.imf.org/external/pubs/ft/aa/index.htm.

[14] *Id.* Article IV, Section 1(iii).

[15] *Id.* Article VIII, Section 3.

[16] *France v. Turkey*, 1927 PCIJ, Series A, No. 10.

[17] *Brazilian Loans case (France v. Brazil)* 1929 PCIJ Series A, No. 21. *Serbian Loans case,* 1929 PCIJ Series A, Nos. 20/21.

[18] *Messageries Maritimes*, *Clunet* 1950, at 1196.

[19] *Clunet* 1965, at 637, obs. Goldman.

[20] *See* Michael Gruson, "The Introduction of the Euro and Its Implications for Obligations Denominated in Currencies Replaced by the Euro," 21 *Fordham International Law Journal* (1997), at 65–108; James H. Freis, Jr., "Continuity of Contracts After the Introduction of the Euro: The United States Response to European Economic and Monetary Union," 53 *Business Lawyer* (1998), at 701–66.

[21] *France v. Norway* (July 6, 1957), 1957 ICJ Reports 9.

[22] *Supra* note 17.

[23] IMF, *Articles of Agreement of the International Monetary Fund*, Article VIII, Section 2(*a*), http://www.imf.org/external/pubs/ft/aa/index.htm.

[24] *See, e.g.*, Security Council Resolution No. 661 (1990) (imposing such sanctions against Iraq after the invasion of Kuwait).

[25] Restrictions imposed solely for the preservation of national or international security, once notified to the IMF, are deemed to be approved unless the IMF, within 30 days, informs the member that it is not satisfied that the restrictions are imposed solely to preserve such security. Decision No. 144-(52/51), August 14, 1952, reprinted in IMF, *Selected Decisions and Selected Documents of the International Monetary Fund,* 29th Issue (Washington: IMF, 2004), at 462–63.

[26] *See* IMF Legal Department, *Suppressing the Financing of Terrorism* (Washington: IMF, 2003), at 14.

[27] UN SCOR 54th Sess., 4051st mtg., UN Doc. S/INF/155 (1999).

[28] UN SCOR 55th Sess., 4251st mtg., UN Doc. S/INF/156 (2000).

[29] UN SCOR 59th Sess., 4385th mtg., UN Doc. S/INF/57 (2001).

[30] UN SCOR 57th Sess., 4452nd mtg., UN Doc. S/RES/1390 (2002).

[31] UN SCOR 59th Sess., 4908th mtg., UN Doc. S/RES/1526 (2004).

[32] *See* Mann, *supra* note 2, at 479–87. According to Mann, "apart from treaties, it would at present not be possible to maintain that customary public international law imposes upon the State the general duty of affording protection to the monetary systems of the other members of the family of nations. The existence of such a duty could be asserted only if the development of international law had progressed so far as to outlaw all activities injurious to a foreign state or even to demand the adoption of positive measures to safeguard a foreign state's interests. This is not the present position."

[33] *See* F. Gianviti, "Le contrôle des changes étranger devant le juge national," 69 *Revue critique de droit international privé* (1980), at 479–502 and 659–703; "The Fund Agreement in the Courts," in *Current Legal Issues Affecting Central Banks,* Vol. 1 (Washington: IMF, 1992), at 1–13 and Comment by P. Francotte, at 14–23; and A. S. Huguenin, *L'application du contrôle des changes étranger par le juge national* (Zurich: Schulthess, 2000).

[34] In favor of the extraterritorial effect of U.S. executive orders freezing holdings of U.S. dollars in foreign banks, see Carreau, "La Souveraineté de l'Etat à la fin du xxe siècle: mythe ou réalité," in *Souveraineté étatique et marchés internationaux à la fin du 20ème siècle, Mélanges en l'honneur de Philippe Kahn* (Paris: Litec, 2000), at 499, para. 28.

[35] *Libyan Arab Foreign Bank v. Bankers Trust Company* (1989), Q.B. 728. For a similar view on the U.S. freeze of Iranian assets, see F. Gianviti, "Le blocage des avoirs officiels iraniens par les Etats-Unis (executive order du 14 novembre 1979)," 69 *Revue critique de droit international privé* (1980), at 279–303.

[36] *See* F. Gianviti, "Use of a Foreign Currency under the IMF's Articles of Agreement," in *Current Developments in Monetary and Financial Law*, Vol. 3 (Washington: IMF, 2005), at 817–28.