(d) The change would bring about a major simplification of the Fund and would thus help to promote understanding of the working of the institution, both among the Fund's membership and by the public at large.

3. This study sketches a restructured Fund, in which transactions could be conducted entirely in SDRs, and compares it with the present Fund. While the Fund as presently constituted can make quantitatively larger use of SDRs and can expand the use of SDRs to more categories of its financial operations,[6] the transition to a restructured Fund cannot, beyond a certain point, be gradual. It would require a major restructuring of the Fund's financial operations and of its assets and liabilities at one moment in time, and this could not take place without a major amendment of the Articles of Agreement. At a time when the Fund has only recently reached the conclusion of a long-drawn-out process of amendment, thoughts about the types of changes described above—whose realization would entail a new amendment—are likely to be of interest more because of their long-term value for a better understanding of the Fund than as proposals for action in the near future.

General Department and Special Drawing Rights Department

The two Departments in the Fund use radically different techniques to perform financial functions for members that are in many respects similar: both Departments enable a member in deficit to use financial resources that it had not earned from a previous balance of payments surplus. Use of the resources in both Departments also has a very similar effect on the member that provides the users with foreign exchange: this member acquires, in both cases, reserves in the form of "Fund-related assets," viz., a "reserve position in the Fund" (a reserve tranche position or a readily repayable loan claim on the Fund) when the transaction

[6] This term is used here in the nontechnical sense and does not specifically refer to "operations" in the sense of the Articles.

takes place in the General Department, and SDRs when it takes place in the Special Drawing Rights Department.

In spite of these similarities, transactions in the two Departments are executed in entirely different ways. In the General Department, transactions take the form of drawings on a pool of currencies contributed by all members, with potential additions to that pool from borrowing and from the sale of gold. Members' entitlements to Fund credit are related to the size of their quotas, but a member cannot regard these entitlements as reserves.[7] Reserves are acquired by drawings, and these drawings are normally made in the currencies of the countries that are selected by the Fund to acquire reserve positions in the Fund. Except when the U.S. dollar is drawn, the currencies sold by the Fund are usually at once presented for conversion by the drawer, so that the drawee country experiences a reduction in its holdings of foreign exchange equal to the increase in its reserve position in the Fund. In the Special Drawing Rights Department, by contrast, the allocation of SDRs, in equal percentages of quotas, by itself gives participants additional reserves, which are then usable as such.

Why this difference between the two Departments in their technical and financial arrangements, if it does not reflect any obvious difference in substance between transactions conducted through them? The explanation cannot lie in the difference in purpose between the two Departments. The fact that use of the General Department is conditional beyond the reserve tranche and subject to rules on repurchase to ensure its temporary character, while the use of SDRs is unconditional and subject only to the rules of reconstitution, could hardly justify reliance on a different technique. It would appear that, in essence, the explanation is historical in nature. The Special Drawing Rights Department is both the newer and the simpler of the two Departments. The more complicated form in the older General Department has clear historical reasons: the U.S. negotiators in the discussions preceding Bretton Woods argued strongly that a Fund operating

[7] A member's net contribution to the Fund in the form of gold or SDRs, or amounts of its currency drawn by other members, is considered as part of its reserves ("reserve tranche").

on the basis of "a mixed bag" of currencies was more likely to win Congressional approval than one which—as proposed in the Keynes plan—introduced the unfamiliar concepts of a new international currency and of overdrafts.[8]

By now, however, these arguments do not have the weight they had 35 years ago.

(1) The concept of an international currency is no longer unfamiliar. On the contrary, the SDR, created by the First Amendment as a "supplement to existing reserve assets," was promoted to the role of the prospective principal reserve asset in the international monetary system by the Second Amendment.[9]

(2) The attempt to view transactions through which the Fund made resources available to members in payments difficulties as a mere exchange of one currency for another never took hold. Fund transactions (beyond the reserve tranche) are now generally regarded as the extension of balance of payments *credit*. This view is reflected, for example, in the adoption of the concept of "credit tranches" and in the widespread use of the term "repayment" as both more general and more meaningful than "repurchase."

(3) By the early 1960s, the approach originally chosen—i.e., that the Fund would *not* be a "bank," creating international money by extending "credit"—had been overcome by the economics of the situation. Up to 1958, the Fund used almost exclusively U.S. dollars in its transactions. The United States did not lose reserves as a result of such use, and in any event U.S. reserves at that time were very large. But when the currencies of other countries began to be drawn, these countries could expect to lose reserve currencies as their own currencies were presented to them for conversion. Since these countries were, in general, reluctant to have their currencies drawn from the Fund if this resulted in a reserve loss, it

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[8] J. Keith Horsefield, *The International Monetary Fund, 1945–1965: Twenty Years of International Monetary Cooperation* (Washington, 1969), Vol. I, pp. 28–30.

[9] See First Amendment, Article XXI, Section 1 (Second Amendment, Article XV, Section 1) and Second Amendment, Article VIII, Section 7.

became necessary to establish the reserve character of the positions in the Fund that members acquired through these drawings.[10] This implied that credit extension by the Fund produced reserve creation as a by-product: while dollars shifted from the country drawn upon to the drawing country, additional reserves would come into being in the form of an enlarged reserve position in the Fund. Accordingly, reserve statistics since about 1963 reflect the view (entirely comparable with the concepts underlying domestic banking statistics) that the extension of international credit by the Fund involves an expansion of reserves, and the repayment of such credit a contraction of reserves.[11]

Given these changes in attitude toward the operations of the General Department and the example of the SDR facility, the question arises whether there is a continuing justification for the present form of the General Department. Perhaps the best way to approach this question is to assume an inversion in the chronological order in which the two functions of the Fund were conceived. Suppose that the founders of the Fund had felt it necessary to concentrate their attention on the need for unconditional rather than conditional liquidity and for this purpose had created a mechanism such as that contained in Articles XV to XXV of the present Articles of Agreement, perhaps combined with regulatory provisions with respect to exchange rates, the avoidance of exchange restrictions, convertibility, etc. Such a Fund would have required quotas both as a basis for the allocation of unconditional liquidity and to determine voting power, but not contributions in gold or in the currencies of all members. Assume

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[10] The term "gold tranche position" was introduced at this time and an explanation was given why these positions should be considered as part of members' reserves (International Monetary Fund, *Annual Report of the Executive Directors for the Fiscal Year Ended April 30, 1963* (Washington, 1963), p. 40). The concept was expanded to "reserve position in the Fund" when loan claims under the General Arrangements to Borrow (GAB) first appeared (*Annual Report, 1965*, p. 68).

[11] For a brief discussion see J. Marcus Fleming, "The Fund and International Liquidity," International Monetary Fund, *Staff Papers*, Vol. XI, No. 2 (July 1964), pp. 183–85. A more detailed description is given in Hannan Ezekiel, "The Present System of Reserve Creation in the Fund," *Staff Papers*, Vol. XIII, No. 3 (November 1966), pp. 398–420.

further that, despite the absence of a learning model which the pre-1969 Fund provided for the SDR mechanism, the provisions on SDRs were exactly those of Articles XV to XXV. If then, at some later time, when the SDR facility had been running smoothly for a considerable period, the Fund had reached the conclusion that it would be opportune to provide, side by side with the SDR facility, another facility under which members could obtain conditional credit for temporary use, how would it have gone about this?

Credit Transactions by the Fund in SDRs

It would seem unlikely that in order to provide this new facility for its members the Fund would have found it necessary to split itself into two Departments and to require each member to make a contribution equal to its quota, with one fourth normally payable in SDRs and the remainder in the member's own currency.[12] Rather, the following approach would have seemed natural.

(1) There would, of course, be a need for a set of provisions determining access to Fund credit, repayment of this credit, and the interest charged for it. These provisions could follow the general lines of the present Article V, Section 3 (*Conditions governing use of the Fund's general resources*), subsections (*a*), (*b*), and (*c*); Section 4 (*Waiver of conditions*); Section 5 (*Ineligibility to use the Fund's general resources*); Section 7 (*Repurchase by a member of its currency held by the Fund*); and Section 8 (*Charges*), subsections (*a*), (*b*), (*c*), and (*d*).

(2) The credit operations of the Fund under these provisions would be conducted in SDRs. Any extension of credit by the Fund would lead to a corresponding creation of SDRs; any repayment to an equal cancellation of SDRs. These fluctuations in the amounts of reserves outstanding would not involve a change in substance from present practice, only one of form: under present practice, similar reserve creation takes place in the form of reserve positions in the Fund when the Fund sells currencies (of members not indebted to the Fund), and reserve destruction when it receives currencies (other than in quota subscriptions). When the Fund

[12] Article III, Section 3(*a*).