Effects on Other Provisions

(*a*) No Need for Separate Departments

If the credit activities of the Fund were run on an SDR basis, the present separation of the two Departments would no longer be necessary, or indeed convenient. In a unified Fund all members that extended credit through the Fund, even if they did not participate in the SDR allocation facility, would have to hold SDRs. That, however, would be predominantly a formal change. All members are now obliged to make their currencies available for sale; hence all members must stand ready, when their reserve and payments position permits, to acquire creditor positions in the Fund. Such positions are denominated in SDRs. Thus, in an economic sense, members are already bound to acquire SDRs.

At the time of the First Amendment it was considered important to permit members of the Fund the choice not to become participants—in addition to the further choice available to participants to opt out of allocations, and with that out of the corresponding acceptance obligations. When the first allocation of SDRs was made on January 1, 1970, ten members, having 2.4 per cent of total quotas, were not participants and one participant (the Republic of China) opted out. But by the time of the 1978 decision for allocations in 1979–81, only one member (Kuwait), accounting for 0.6 per cent of total quotas, was not a participant; also, no participant opted out from that allocation. The strong movement in the direction of general participation in the Special Drawing Rights Department suggests that there may not be a need, in an integrated Fund, to leave open the possibility for any member to be excluded from the activities of the Fund related to the allocation of SDRs.[17] The right to opt out gives a member

[17] The direct financial benefit that a member derives from nonparticipation in the Special Drawing Rights Department, viz., that it does not share in the cost of that Department, was treated as a somewhat serious matter at the time of the First Amendment (see Second Amendment, Article XVI, Section 2, last six lines and Article XX, Section 4). The costs have, however, proved to be minimal—about SDR 1 million a year. Dropping these special provisions and the allocation of costs they require would provide another welcome, if small, simplification.

important influence; this right, together with its impact on the size of a member's acceptance obligation, should no doubt be preserved.

The merger of the two Departments would do away with the differences that now exist between the two types of Fund-related assets in members' reserves: reserve positions in the Fund and SDRs. It is generally agreed that it would be desirable for these assets to be as similar as possible; but, in fact, the difference between them has been increased in the wake of the Second Amendment, as improvements in the quality of the SDR brought about by or pursuant to that amendment were not, or not to the same extent, extended to reserve positions in the Fund. Thus, the interest rate on the SDR was raised more than the rate of remuneration, and the changes in the direction of easier and wider use of the SDR cannot apply to reserve tranche positions in the Fund.

In one respect, however, the amended Articles permit the elimination of an important difference between SDRs and reserve tranche positions in the General Department. They permit the Fund to make it unnecessary for a member to use its reserve tranche position before it uses Fund credit in any form. The Fund can decide (by an 85 per cent majority of the total voting power) that not only drawings under the compensatory financing facility and the buffer stock financing facility but also use of the Fund's general resources in the credit tranches and under the extended Fund facility will be segregated from use of the reserve tranche.[18] This would permit a member to maintain any part of its reserve tranche that it wanted to maintain while using the Fund's credit tranches, in the same manner as it can preserve its holdings of SDRs.

(*b*) No Holdings of SDRs by Fund

The provision under which one part of the Fund, the General Department, can hold the assets issued by another Department is

[18] The power for the Fund to make this change is tucked away among the provisions of the Articles dealing with "Explanation of Terms" (Article XXX (*c*) (iii)). The power has been exercised with respect to drawings under the oil facility.

strictly related to the concept of the Fund as consisting of two Departments. An integrated Fund would not hold SDRs on its balance sheet, just as the Federal Reserve Banks do not hold Federal Reserve notes. SDRs would be issued when credit was extended and canceled when credit was repaid. Thus, perhaps somewhat ironically, one of the consequences of making the SDR the principal instrument in Fund transactions would be that the Fund would cease to hold any SDRs.

What would happen to the Fund's income now derived from its holdings of SDRs? The Fund would continue to receive it, because, for the Fund as a whole, that income does not so much derive from the holding of SDRs by the General Department as from the fact that aggregate holdings outside the Fund are below the total of allocations, so that the Fund, as the issuer of SDRs, takes in more in charges than it pays out in interest.

(*c*) Aspects of Fund Income

Much of the discussion in recent years on the ability of the Fund to pay its way, i.e., to cover its administrative expenditure from its net operational income, has been addressed to the margins that are necessary between the various charges that the Fund levies and the rates it pays on money used, either as remuneration or as interest on loans. These aspects of the Fund's financial position would remain unchanged, except that the Fund would no longer have the power it acquired under the Second Amendment to pay as

[19] Paragraph 5(a) of the communiqué of September 24, 1978 of the Interim Committee reads in part: "It was agreed that the interest rate on the SDR should be increased from 60 per cent of the weighted average of the short-term interest rates in the five member countries with the largest quotas to 80 per cent of that average and that the rate of remuneration should be set at 90 per cent of the interest rate on the SDR, that is, at 72 per cent of the combined market rate. . . Shortly before the end of each financial year, the Fund would consider whether the estimated net income of the Fund for that year was sufficiently large to permit the average annual rate of remuneration applicable for that year to be raised to a level above 90 but not above 100 per cent of the average annual rate of interest on the SDR." See International Monetary Fund, *Summary Proceedings of the Thirty-Third Annual Meeting of the Board of Governors, 1978* (Washington, 1978), p. 309.

remuneration up to one-fifth less for money used in the General Department than is received as interest by the holders of SDRs, a power of which it intends to use half, or less than half to the extent that the Fund's net income permits.[19]

The discussion of the fine tuning of various rates of Fund income and expenditure has tended to obscure the fact that there would be a very large gap in the Fund's financial accounts if it did not have large interest-free resources of an amount roughly equivalent to its gold holdings. Since gold holdings yield no income, the Fund cannot pay interest or remuneration on the corresponding liabilities. Under the Articles of Agreement as they stood prior to the Second Amendment, this economic reality was, in an approximate manner, taken care of by the provision that remuneration was paid only on gold tranche positions in excess of 25 per cent of quota. Since gold payments for quota increases ceased for all practical purposes with the Second Amendment, the definition of the unremunerated part of the reserve tranche of each member was adjusted from a fixed percentage of quota to the absolute amount at which it stood at the time of the amendment.[20] The effect of this provision was that for each member that paid its quota increase under the Sixth General Review of Quotas fully in its own currency, the amount on which it received remuneration remained unchanged at the time its quota increase went into effect. But it also meant that, since quotas were adjusted by very different percentages in the Sixth Review, unremunerated reserve tranches now constitute very different percentages of quotas, ranging from 3.1 per cent for the United Arab Emirates to 23.9 per cent for the

[20]This follows (not without some difficulty) from Article V, Section 9(*b*). The steps are as follows. The remunerated part of the reserve tranche of any member equals the "norm" less the Fund's holdings of that member's currency; the unremunerated part equals the quota minus the "norm." The "norm" is 75 per cent of the member's quota at the date of the Second Amendment plus payments made by the member in currency (its own as well as that of other members) or SDRs for quota increases after that date. Such payments must equal 100 per cent of quota increases after the date of the Second Amendment. Hence, the "norm" equals a member's current quota minus 25 per cent of its pre-amendment quota, and the unremunerated part of the reserve tranche equals 25 per cent of the pre-amendment quota, i.e., the same amount as before quota increases pursuant to the Sixth General Review of Quotas and any subsequent reviews.

United Kingdom (and 25 per cent for the Republic of China). The Articles also provide for downward adjustment of these percentages unrelated to quota increases.[21]

Although there are various reasons why the Fund's holdings of gold and the total of unremunerated reserve tranche positions differ, in fact the two amounts are reasonably close: at the end of July 1978, the Fund's gold holdings were SDR 4.44 billion (valued at SDR 35 per ounce) and unremunerated reserve tranche positions SDR 5.24 billion. As long as the Fund holds substantial amounts of gold, some provision under which a roughly corresponding amount of its liabilities is made available to the Fund on an interest-free basis will continue to be necessary. At the same time, the sale of gold by the Fund without a reduction in the size of unremunerated reserve tranches can substantially improve the Fund's financial position. Thus the present four-year program for the sale of 50 million ounces of gold will yield to the Fund SDR 1.75 billion in currencies, since the Fund receives SDR 35 per ounce and all the profits accrue to members. Assuming a rate of remuneration of say 5 per cent per annum, this would produce an improvement in the Fund's financial position of nearly SDR 90 million a year.

In an SDR-based Fund, the need for a certain amount of interest-free resources could be met by a provision to the effect that a member's SDR holdings up to *x* per cent of quota would not earn interest. The percentage could be selected in such a way as to provide the Fund with an appropriate initial amount of interest-free funds,[22] and a further provision of the general nature of Article V, Section 9(*c*) could determine the decline of this percentage over time.

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[21] Article V, Section 9(*c*) permits reduction of the percentage "on the basis of the same criteria for all members"; the economic justification for such reduction could well be the sale of gold by the Fund against currencies, since the receipt of additional currencies would, in itself, reduce the amount on which the Fund would have to pay remuneration.

[22] In setting this amount, allowance could be made for any increase in the cost of the Fund's credit operations as a result of the need to pay the SDR interest rate, rather than 90 per cent of this rate, for the resources used.

This technique would be subject to the same two drawbacks as attach to the present system of an unremunerated portion of the reserve tranche: (a) the Fund's net income is crucially dependent on the extent of use of the Fund's resources in this portion of the quota and (b) while the benefits of the Fund's holdings of gold accrue to all members, only those members that would have SDR holdings of at least x per cent of quota would bear their full share of the cost involved. An alternative approach that would avoid these difficulties would be to add to the amount on which SDR *charges* are paid *to* the Fund, rather than subtract from the amount on which SDR *interest* is paid *by* the Fund. At present, charges are paid by each participant on the amount of its net cumulative allocation. This base could be broadened by the addition of y per cent of quota for all members.[23] Since under this approach the cost of holding gold would be shared among all members, y could be considerably below x. Thus, the amount of unremunerated reserve tranche positions outstanding on July 31, 1978 of SDR 5.24 billion represents about 13.5 per cent of total quotas ($y = 13.5$), but the typical country with a creditor position in the Fund forgoes remuneration on an amount equivalent to about 19 per cent of its quota. Thus, on average, $x = 19$, but as indicated earlier in this section, the range among members is very wide.

(*d*) A Single System to Reduce a Member's Use of Fund Credit

At present, use of Fund credit can be reduced in two ways: by repurchase and by Fund sales of the currency of the member that had drawn. Only the first of these would remain as a technique in an SDR-based Fund. It may be noted in this connection that the Fund has recently given explicit recognition to the fact that the sale of the currency of a member using the Fund in the credit tranches is equivalent to early repurchase by that member, and has consolidated its practices on early repurchase and on the sale of

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[23] This percentage could be allowed to decline in the same manner as suggested above for x.

the currencies of members that would be subject to the rules on early repurchase.[24]

(*e*) A Single System to Guide Increases and Decreases in Members' Positions in the Fund

At present, there are two systems for selecting members that are to acquire additional positions in Fund-related assets on the basis of the strength of their balance of payments and reserve position: the "operational budget" for the selection of currencies to be sold for the General Department[25] and the "designation plan" for the Special Drawing Rights Department.[26] The first of these systems has a matching system for the selection of countries whose positions in Fund-related assets are to be reduced: the repurchase part of the "operational budget."[27] Members that need or desire to acquire SDRs can obtain them either in bilaterally agreed transactions or from the General Department; in the latter case, the repurchase part of the operational budget is in fact used to select the currencies to be paid in exchange for SDRs.

In an SDR-based Fund, the operational budgets would of course disappear, but it would be necessary to introduce a system of "reverse designation" to ensure that members could acquire SDRs as needed, e.g., to repay credits and to pay charges.[28] In other words, the contingent obligation for members to reduce their holdings of Fund-related assets that now attaches (in practice) only to reserve positions in the Fund would have to apply to SDR holdings.

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[24] Executive Board Decision No. 5704-(78/39), adopted March 22, 1978; see *Selected Decisions of the International Monetary Fund and Selected Documents: Supplement to Eighth Issue* (Washington), December 4, 1978, p. 41. Also reproduced in *Annual Report, 1978*, pp. 125–26.

[25] Article V, Section 3(*d*).

[26] Article XIX, Section 5 and Schedule F.

[27] Article V, Section 7(*i*).

[28] The present Articles contain rudimentary provisions for "reverse designation" to enable a participant to acquire SDRs to pay charges and assessments or to meet its reconstitution obligation. These have never been used as sufficient SDRs could always be acquired from the General Department.

(*f*) Holdings of Currencies

An SDR-based Fund would still need to hold a small amount of currencies for administrative expenditures, and it could hold currencies or assets denominated in currencies for at least two further purposes:

(i) those of the Investment Account; and

(ii) those of the Special Disbursement Account.

It is interesting to note that under the present Articles the holdings in these two Accounts also fall outside of the normal structure of the Fund in the sense that these holdings are not subject to maintenance of value.

The Fund would have to be empowered to acquire currencies against SDRs for administrative expenditure, and it presumably would acquire currencies when it sold gold. At present, currencies derived from gold sales, to the extent that they are not turned over to the Trust Fund, reduce the reserve tranche positions of their issuers. In an SDR-based Fund, the currencies received from the sale of gold (to the extent that they were not transferred to the two Accounts mentioned above) could be exchanged for SDRs through an extension of the reverse designation mechanism referred to in the preceding subsection.

(*g*) The Appointment of an Executive Director by the Largest Creditors

There is one important provision that would lapse in its present form and would clearly need to be replaced by an appropriate substitute provision. This is the right for the two largest creditors in the General Department to appoint an Executive Director to the extent that they do not have this right on account of the size of their quotas (Article XII, Section 3(*c*)). A substitute provision could no doubt be devised that based the right to appoint an Executive Director on the combined amounts of a member's holdings of SDRs and loan claims.[29]

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[29] A substitute criterion could also be found, in the unlikely event that this were considered desirable, for the adjustment of voting rights that the present Article XII, Section 5(*b*) prescribes for creditors and debtors in certain decisions.