

MASTER FILES

ROOM C-120

D4

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 84/186

3:00 p.m., December 17, 1984

J. de Larosière, Chairman

Executive Directors

C. H. Dallara
J. de Groot
B. de Maulde
M. Finaish
H. Fujino
G. Grosche
J. E. Ismael
R. K. Joyce
A. Kafka

Y. A. Nimatallah
P. Pérez
J. J. Polak
A. R. G. Prowse

J. Tvedt
N. Wicks
S. Zecchini

Alternate Executive Directors

N. Toé, Temporary
M. K. Bush

X. Blandin
T. Alhaimus
M. Sugita
B. Goos
T. Sirivedhin, Temporary

H. A. Arias, Temporary
A. S. Jayawardena
V. Govindarajan, Temporary
J. A. K. Munthali, Temporary
C. A. Salinas, Temporary
E. M. Ainley, Temporary

A. V. Romuáldez
O. Kabbaj

N. Coumbis
Wang E.

L. Van Houtven, Secretary
S. J. Fennell, Assistant
R. S. Franklin, Assistant

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Also Present

Administration Department: L. A. Wolfe. External Relations Department: G. P. Newman. Legal Department: G. P. Nicoletopoulos, Director; J. G. Evans, Jr., Deputy General Counsel; Ph. Lachman, A. O. Liuksila, S. A. Silard. Middle Eastern Department: M. Arif. Treasurer's Department: W. O. Habermeier, Counsellor and Treasurer; D. Williams, Deputy Treasurer; D. Berthet, D. H. Brown, D. Gupta, R. B. Hicks, B. E. Keuppens, A. W. Lake, T. B. C. Leddy, J. T. McDonald, G. Wittich. Bureau of Statistics: W. Dannemann, Director; A. C. Bouter, J. B. Gupta. Office of the Managing Director: C. P. McCoy. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: G. R. Castellanos, D. Hammann, G. E. L. Nguyen, P. Péterfalvy, G. W. K. Pickering, A. Vasudevan. Assistants to Executive Directors: H. Alaoui-Abdallaoui, I. Angeloni, W.-R. Bengs, M. B. Chatah, L. E. J. M. Coene, G. D. Hodgson, Z. b. Ismail, A. K. Juusela, H. Kobayashi, S. Kolb, R. Msadek, A. Mustafa, M. Rasyid, R. G. Toulmin, L. Tornetta, A. J. Tregilgas, A. van Ee, E. L. Walker, B. D. White.

1. OVERDUE FINANCIAL OBLIGATIONS - EFFECT ON INCOME AND TREATMENT IN FINANCIAL STATEMENTS

The Executive Directors continued from the previous meeting (EBM/84/185, 12/17/84) their consideration of a staff paper on the effect on income and the treatment in financial statements of overdue financial obligations to the Fund (EBS/84/231, 11/14/84).

The Treasurer, responding to a question raised by Mr. Wicks at EBM/84/185, observed that the drafters of the international accounting standards had probably not had in mind the peculiarities of the Fund in establishing their standards. Still, the staff of the Fund gave weight to those principles in preparing the Fund's financial statements, in part because the external auditors insisted that, in the absence of specific rules in the Articles of Agreement on accounting, the Fund's statements must be prepared consistent with generally accepted accounting principles.

It had been suggested by Mr. Wicks that putting off until much later any decision not to accrue unpaid charges as net income could have severe consequences for the Fund's income and charges when the decision was finally taken, the Treasurer noted. Without disputing Mr. Wicks' argument, he noted that the staff's proposed approach to the arrears problem--namely, to consider increasing the net income target--could also soften the impact of overdue obligations on the Fund's income and reserves if it became necessary at a later stage to place certain income on a cash basis. He hoped that the Fund was not put in a position of having to take any other decisions of the kind that had been adopted with respect to Kampuchea; if members could be relied upon to be more efficient and timely in meeting their financial obligations to the Fund, such decisions would not be necessary. Also, it would be difficult to treat overdue principal differently from overdue charges.

Mr. Nimatallah observed that there was good reason for separating overdue principal from overdue charges. Charges normally appeared in statements of profit and loss, which were flow statements covering a period between specified dates, while repurchases of principal tended to be of an asset or stock and normally appeared in balance sheets painting a financial picture at a particular point in time. The link between the two elements was reserves, which were usually put aside to improve an institution's financial position after dividends were paid. Of course, the Fund was not a profit-making organization, but it did tend to put aside reserves to improve its net worth. If in future it became clear that charges placed on an accrued basis would in time affect the Fund's income because of their accumulated size, and depending on their relative size in relation to the level of the Fund's reserves at the time, a judgment might have to be made to stop counting the unpaid charges as accrued income and to begin counting them as deferred income.

Such a decision would not need to be made quite so soon with respect to repurchases, which were assets, Mr. Nimatallah continued. Of course, overdue principal could not be ignored; however, so long as it was assumed

that the member ultimately would pay, no change in accounting with respect to principal was necessary; it was only with regard to the yearly "flow" of charges in the income/expenditure statements that a decision might need to be adopted somewhat sooner to strengthen reserves because the magnitude of delayed charges was increasing.

Having determined at some point to change the method of accounting for unpaid charges, ways of retrieving or compensating for those amounts must be found, Mr. Nimatallah considered. One possible approach was to increase the rate of charge for those Fund borrowers that were not paying their charges on time; another possibility, which he had outlined in earlier statements, was a graduated penalty charge. Only if those approaches failed to produce sufficient income to compensate for the losses written off by the Fund should the Executive Board consider an increase in charges on all users of Fund resources.

The Treasurer agreed with Mr. Nimatallah that there were differences between income and assets. He also had no difficulty with Mr. Nimatallah's characterization of reserves except to say that, apart from adding to the liquidity and general financial security of the institution, reserves also served to even out the impact on charges of fluctuations in net income from year to year. That was why the staff had suggested an increase in the reserve target as a first option for the Board to consider in responding to an increase in the size and duration of overdue financial obligations.

There was some question about how much income would be produced if the Fund increased charges for those members that were not at present paying their charges, the Treasurer remarked. The staff was examining the issue of penalty charges and would look as well at Mr. Polak's latest proposal for a "corrective" charge for the losses incurred by the Fund as a result of late payments. However, even if the Board could agree on the amount of any such proposed increase in charges and on the particular amounts to which they would be applied, there was no way to tell how much actual income they would produce. Indeed, the effect of additional charges was highly uncertain: some had argued that the imposition of a penalty charge would encourage more rapid repayment, while others felt that it would cause the member to give up hope in the face of sharp increases in the cost of servicing their debts to the Fund.

Mr. Nimatallah observed that the best way to determine the answer to the question at hand was to implement the penalty charge and see what happened.

The Treasurer recalled that a question by Mr. Dallara about whether or not the issuance of a complaint to the Board by the Managing Director within a three-month period was sufficient reason for publishing information on payments overdue for longer than three months. A complaint was issued irrespective of whether or not the arrears in question were deemed to be material; and, while the decision to issue a complaint was certainly a serious step and indicated the existence of a problem, it should not

necessarily "trigger" publication. The staff's preference for a six-month period before publication had been put forward on the understanding that the Executive Board would have taken some substantive action on the Managing Director's complaint by that time and would thus have considered the materiality of the arrears in question. Finally, the staff had not drawn a distinction in its proposals between those members with financial obligations overdue for six months or more and those with so-called continuous arrears for a period exceeding six months even though no individual obligation had been outstanding for that period. The Executive Board might wish to review those distinctions as part of its consideration of the publicity issue.

The staff representative from the Treasurer's Department, responding to a suggestion by Mr. de Maulde on the formulation of forecasts of arrears, observed that the Fund's experience with overdue charges was relatively new. There were difficulties inherent in the use of data on outstanding overdue charges for determining the repayment experience. Data for 1984 showed that at the end of the first half-yearly period, the amount of charges overdue by more than three months and those overdue by more than six months were the same--namely, SDR 2.3 million. All those charges had been paid during the next half year; however, other charges had not been settled when due so that at the end of the year, overdue obligations had increased to SDR 5.5 million, also on a three-month and six-month basis. Overdue charges had risen during the current fiscal year and, at present, SDR 30.2 million were three months overdue, and SDR 7.3 million were six months overdue, although the amount had fluctuated considerably from month to month. The average might thus provide a better indication of overdue obligations than the amounts on any particular date. The average over the past six months of charges that had been outstanding for six months or more equaled SDR 6.8 million, and the average of those that had been outstanding for three months or more amounted to SDR 11.8 million.

A question had also been raised with regard to Formula 3 in Table 1 on page 15 in EBS/84/231, the staff representative continued. Mr. Dallara had asked how much the increase in the target would have been if the formula included more than one third of overdue repurchases. The total of overdue repurchases from members that had been more than six months late in making payments had amounted to SDR 36 million at end October 1984. Incorporating the entire amount in Formula 3 would necessitate a net income target of SDR 41.7 million in FY 1986, which would require an increase of 0.20 percent in the rate of charge.

Mr. de Maulde said that he could accept the staff's argument that forecasting of future overdue obligations was extremely difficult and could be based only on historical trends, which themselves were not conclusive. However, the total of financial obligations overdue by three months or more at end October 1984 had been SDR 26.2 million, while the total overdue by six months or more had equaled SDR 4.0 million. It was clear that most of what was outstanding after three months was repaid in the following three months, and it was only the remainder that should be

taken into account if it was decided that charges should be accrued to income only when they were actually paid. As he understood Mr. Wicks' proposal, the idea was to count income only when it had been paid in, so that the forecasting exercise became one of determining how much of what had accrued during a given fiscal year would actually be paid; and it would be the difference that would have to be taken into account in determining the rate of charge.

Mr. Fujino remarked that there appeared to be very little difference between operating on a budget basis or an accrual basis if there was not a rising trend to the arrears.

The Treasurer, agreeing with Mr. Fujino, noted that two problems arose in connection with Mr. de Maulde's suggestion. First, Fund experience in making plausible and defensible estimates about arrears was limited. Second, the trend of overdue obligations was rising, albeit in a peculiar way because of the arrears of one country. Mr. de Maulde's estimation procedure would be perfectly acceptable in a commercial bank with thousands of customers and loans, and where those large numbers facilitated forecasting and the identification of trends. Such an approach was not possible in the case of the Fund, where only a few members were involved and where amounts overdue long enough to fall under the procedure might be so large that they would produce erratic swings in the Fund's income.

The Chairman said that as he understood it, the World Bank did not identify the names of those countries in arrears to it but provided instead only an aggregate figure. He would like to know the rationale behind the World Bank's approach before asking Directors to adopt a particular approach with respect to overdue obligations to the Fund. It was true, of course, that the World Bank had a problem not experienced in the Fund--namely, a requirement to abide by the necessary regulations pertaining to the financial markets in which the World Bank borrowed resources.

It was important to ask what elements the Fund should have in mind in determining the approach it should take to disclosing information on members' arrears, the Chairman continued. If the matter was simply one of keeping the general public and the markets informed, it would be appropriate to ask why they should be informed by the Fund in any more detailed or precise a fashion than by the World Bank. It was also reasonable to ask what sort of disclosure was necessary to exert some pressure on those countries that were in arrears and whether the World Bank had given thought to that issue in deciding upon its own approach.

The Treasurer replied that his understanding of World Bank policy was that the Bank would not publish the name of any country in arrears, irrespective of whether that information had already become public through other means. The Bank published only aggregate data on arrears overdue by three months or more. The Fund staff had observed in EBS/84/231 that it was not necessary to provide more than the total of overdue obligations

to be in compliance with the principles of proper accounting and financial reporting. However, World Bank staff and management considered all overdue obligations to be immaterial; and they were publishing information not because they were required to--as would be the case for the Fund if the amounts in question were deemed to be material--but because they believed that such reporting would enhance the perception of the buyers of World Bank bonds about the precise financial situation of the institution. The Bank's underwriters had told Bank officials that while it was not necessary, it was highly desirable to publish even the smallest arrears overdue by more than three months, which was the period used by commercial banks in the United States.

The Fund staff was recommending that the Executive Board, if it decided to publish information on members' arrears, should consider identifying individual member countries, the Treasurer continued. The idea was not so much that publicity of detailed information on individual countries would necessarily help in the collection effort; indeed, it could have the opposite result. The main reason for recommending more detailed publication was twofold. First, such an approach would be consistent with the practice followed in the SDR Department of revealing names of individual countries and the amounts relating to them. Second, given the nature of the Fund's operations and the influence it exerted when commercial bank financing packages were being put together, the publication of only aggregate data could easily lead to speculation about which debtors were in arrears, and "innocent" members might be wrongly accused. More generally, it was felt that because the Fund was a public institution with heavy responsibilities in the area of international finance, it should be as open to the public as possible with regard to its financial condition within the general guideline that it should not act in a way that was detrimental to individual members.

Mr. de Maulde remarked that in its prospectus for potential subscribers of bonds, the World Bank had in the past mentioned that it never had any arrears; recently, the Bank had taken a decision no longer to publish that particular sentence, which did not correspond to reality. In that respect, there had been no specific decision by the Bank to discuss whether or not a global figure or figures corresponding to individual countries would be mentioned; it was only now that the Bank was considering how such information should be mentioned in its accounts, and it had been agreed to take a similar approach with respect to information that was reported to the public in any other way.

Mr. Nimatallah observed that because the lenders to the Bank mainly purchased bonds and notes floated by that institution, they did not worry about the arrears situation of any particular member because they knew that the capital was callable from member countries upon presentation of the bonds. Fund operations were somewhat different, and lenders who participated in financing packages for individual members were naturally interested in the situation of the particular member being financed. In that respect, the Fund had a twofold responsibility: the first was to ensure its own financial integrity by providing accurate aggregate data

as part of its financial statements; the other was to inform commercial banks and other creditors about what was happening with respect to the particular members for which financing packages had been arranged. For the ordinary publicity required by good accounting standards, he saw no need to be particularly detailed; but for more "active" publicity on arrears of members, the names of individual countries should be revealed.

Mr. Wicks, taking note of World Bank policy with respect to arrears overdue by at least three months, said that he wondered whether Bank policy changed with respect to arrears overdue by six months or more. As he understood it, there was only one such case in the World Bank.

The Treasurer replied that according to senior Bank officials, there was no intention of reporting the name of the particular country to which Mr. Wicks had referred, although the Bank's reasons for not doing so had not been clarified.

Mr. Dallara, elaborating briefly on the judgment by the United States that individual country data on arrears should be published in the Fund's quarterly financial reports, said that he was in no position to shed any light on the rationale behind the policies and practices of the World Bank, although he would echo a point made by Mr. Nimatallah that for the World Bank or any other debtor depending upon the private markets, there was a clear and distinct relationship between creditor and debtor. The situation was somewhat different in terms of the relationship between the Fund and the financial markets in the sense that the Fund could argue that the financial soundness of the private international banking community was in some respects more dependent upon the Fund and its policies--although there was no direct financial relationship--than was the case for other institutions, particularly in light of the significant linkages that had arisen in the past few years between the markets and Fund-supported programs. Given that the private financial community was working closely with the Fund in making its own financial decisions, it seemed to him that any decision the Fund might take concerning publication of data on arrears of its members should be as detailed as might be considered appropriate in the circumstances.

Another argument in support of the views of the United States on the matter of publicity was related to the important role of the Fund as defined by the Articles of Agreement, Mr. Dallara continued. It was clear that the Articles established a framework for regulating financial relations among member countries; those provisions seemed to highlight the responsibility of the Fund in playing a major role among international financial institutions.

Mr. Joyce added that the extent to which details were disclosed by the World Bank depended almost entirely on what was necessary to ensure the credibility of the Bank. The extent of disclosure by the Fund was what was judged necessary to ensure the credibility of the Fund and the health of the international monetary system. In that respect, the Fund's responsibility with respect to disclosure could even be seen as part of the surveillance exercise.

Mr. Kafka stated that he could not support the line of argument adopted by recent speakers. It was clear that generally accepted accounting rules did not require the naming of individual countries, and great care should therefore be taken before adopting such an approach. To provide more detailed data than was required by accounting rules must be seen as an attempt at punishment, since there was no way of telling whether such an approach would increase the collectibility of arrears. In his view, countries were failing to pay the Fund, not because they were deserving of punishment but because they did not have the money to pay or because the choices for using the money were not choices at all, as was the case when a country was faced by the option of paying the Fund or providing milk for starving children. If the accounting rules did not require publication of information of arrears of individual members, then the Fund should not adopt such an approach, which could only be viewed as aggressive and punitive.

Mr. Prowse said that as he understood it, the role of the World Bank vis-à-vis the commercial banking community was quite different from that of the Fund, which could be seen as a kind of central bank. In that respect, it was the Fund's responsibility to indicate to the world community that there had been a trend toward less timely payment of obligations; and the institution would certainly wish to avoid being put in a position in future of having to announce suddenly that a serious arrears problem existed about which the Fund had not given adequate warning. Once it was accepted that the Fund should publish information on arrears, the issue became one of the timing of such publicity and the extent to which the published data should be disaggregated. Having heard no indication from the staff that published information on individual countries would not be conducive to more rapid repayment, he could go along with publication of such information on obligations overdue for at least six months or some other reasonable benchmark.

On the subjective and somewhat emotional subject of the priorities that members should establish in deciding how to use any financial resources that might be available to them, Mr. Prowse said that he was inclined to accept the indication of the Chairman in his summing up at the conclusion of EBM/84/167 (11/19/84) that he had "heard of no case where the discharge of a Fund obligation on time was an absolute impossibility." That issue was of course a matter of judgment, which seemed to strengthen the argument for establishing a threshold for publication of information on the basis of the length of time the obligation had been overdue rather than on the basis of judgment about a member's willingness or ability to pay.

Mr. Polak stated that the most convincing argument that he had heard for listing the names of individual countries in arrears was that such a list would, by omission, show all those members that were current in their obligations to the Fund. If that was considered important, then there would be no need to attach to individual countries specific amounts of overdue principal and interest; rather, a total amount of overdue charges and overdue repurchases could be shown, together with a listing

of the individual countries responsible in aggregate for those amounts but without specification of the proportion of the total for which each country was responsible.

The Chairman replied that if the Fund were to go as far as Mr. Polak was suggesting, it might as well relate specific arrears to individual countries to avoid undue speculation. It could be argued that naming individual countries and their arrears was part of the surveillance function of the Fund.

Mr. Kafka remarked that the arrears in question were so small that no one could conclude from their publication that the arrears problem was widespread. The Board had not yet decided to publish surveillance reports on the relationship between the Fund's surveillance function and the publicity of information on arrears; nor had it decided that surveillance should be carried out by means of publicity.

Mr. Fujino said that his preference would be not to relate the issue of publicity of information on members' arrears to the Fund's surveillance function. There were sufficient and convincing reasons for giving publicity to obligations overdue by six months or more without attempting to justify such publicity as part of the Fund's role in surveillance.

Mr. de Groote observed that if the Fund published all relevant data on a member's arrears once the obligations had been overdue for six months, it would have no additional leverage to exercise later in the effort to collect the debt. It was for that reason that he had earlier suggested a two-tier system whereby information on obligations overdue by six months or more would be published only after a further intervention in the matter by the Executive Board. In that brief period, it would become clear whether or not the country was intending to reimburse the Fund. Without such an approach, there was not much advantage in a country repaying after the information had been published.

Mr. Grosche remarked that the Fund already had at its disposal a number of sanctions of increasing stringency that could be imposed upon members, so that the two-tier approach proposed by Mr. de Groote was perhaps not necessary. Apart from that, he wished to associate himself with previous speakers in noting that the Fund had a special responsibility to disclose information on members' arrears because of the institution's central role in the international monetary system.

Mr. de Maulde said that he was inclined to support the approach recommended by Mr. de Groote. The Fund did not usually employ automatic approaches in dealing with its members; and he would prefer that a decision be taken each time by the Executive Board on whether or not to publish.

Mr. Kabbaj reiterated that of a decision to publish information on members' arrears would create an ambiance on relations between the Fund and its members that was not conducive to a worthwhile exchange of information and views, especially given the move toward enhanced surveillance.

The Chairman remarked that Mr. Kabbaj had properly raised a very important question, particularly since any decision that might be adopted by the Board at the present meeting was likely to be passed by only a small majority. Perhaps it would be useful to hear from the Director of the Bureau of Statistics about the likely response of members to possible disclosure of information on their arrears.

The Director of the Bureau of Statistics said that he was not in a position to judge how members would react to any decision to publish information on their arrears. As noted earlier by the Treasurer, giving publicity to aggregate information on arrears to the Fund could be considered a requirement of standard accounting principles demanding an accurate picture of the institution's financial position. Such an approach was certainly consistent with the practice followed in the publication, for example, of balance of payments statistics. The publication of more detailed data, including arrears of individual member countries, was a matter of Fund policy.

The Chairman asked why the Fund disclosed information on overdue obligations of individuals in the SDR Department but did not take the same approach with respect to the General Department.

The Treasurer replied that the decision to publish such information in the case of Kampuchea, for example, had not been taken by the Executive Board; rather, the decision had been a managerial matter--albeit with tacit agreement of Executive Directors--based on the fact that unlike the General Department, which was backed by reserves, the SDR Department had no backing in the form of gold or currencies. Hence, when a member was overdue in its obligations to the SDR Department, nonpayment led automatically to an increase in the amount of SDRs outstanding and placed an additional burden on other participants that were fulfilling their obligations.

Mr. Wicks observed that since the Fund already published a great deal of information about its members, particularly with respect to their balance of payments, it was pertinent to ask whether the Fund would not be misleading the public if it failed to publish everything relevant to a member's balance of payments position. In his view, the fact that a member was overdue in its obligations to the Fund by more than six months was a material fact, and detailed information surrounding arrears so long overdue should be published. In that respect, he was moderating his approach somewhat from the one for which he had earlier expressed a preference--namely, to publish after only three months. Agreed Fund procedures called for the issuance by the Managing Director of a complaint once a member was overdue in its obligations by three months; however, a somewhat longer period would give a member sufficient time to put its financial affairs in order; after that, failure to publish information might lead to accusations that the Fund was not presenting a fully truthful picture.

Mr. Polak noted that in those cases where arrears were considered important--as in the case of Turkey, for example--the Balance of Payments Yearbook did include some disaggregated data, breaking down the country's debt by various categories of creditor. He wondered whether it would be consistent with the practices followed by the Bureau of Statistics to include in such a breakdown the arrears to the Fund, which he assumed would be considered an important creditor.

The Director of the Bureau of Statistics replied that while it was not the practice of the Bureau to publish such information, there was nothing to prevent it from doing so.

The Director of the Legal Department added that neither the Articles of Agreement nor the Rules and Regulations of the Fund prevented the institution from publishing facts available to it other than certain information provided by individual members. In the absence of such a prohibition, the publicity question was one of policy to be adopted by the Executive Board.

Mr. de Groote inquired whether the Board was obligated at the present meeting to take a decision on the issue of publicity, perhaps with only a small majority. The discussion thus far had produced a number of new aspects to the matter that had changed his own perspective somewhat. Perhaps a further round of discussion and reflection on those new elements would lead to a more balanced decision that might command broad support.

Mr. Polak and Mr. Pérez stated that they could go along with Mr. de Maulde's suggestion to hold a further discussion on the publicity question.

Mr. Wicks said that while he was prepared to take a decision at the present meeting, he would not insist on doing so.

Mr. Grosche indicated that he wondered whether a further discussion would call for a new paper on the subject. If it did, the staff should approach the issue by comparing what was done with respect to overdue charges in the SDR Department with the approach taken to overdue payments in the General Department. Such a comparison would seem to weaken the argument of some that the Fund would be unduly harming member countries by publishing data on the arrears of individual members. It was, in his view, clear from the current discussion that most Directors were agreed that arrears to the Fund were important--and therefore "material"--and deserving of a response. His own view was that the appropriate response was one consistent with the approach adopted to overdue obligations in the SDR Department.

Mr. Dallara said that while he too was prepared to reach a judgment on the publicity question at the present meeting, he recognized that a number of points had been brought to light that might call for further reflection. If the issue were to be brought back to the agenda of the

Executive Board at some early date for further consideration, he would find it helpful if some additional staff work were done on the subject, focusing, in particular, on two areas. First, it would be useful if the staff could provide more examples of the formula approaches (mentioned in EBS/84/231) to increasing the Fund's net income target on the basis of increases in the level of outstanding overdue payments. Second, it would be helpful if the staff could provide attachments similar to that in Appendix II, giving examples of what an entry in the Balance of Payments Yearbook, in IFS and in the Annual Report would look like if a decision were to be adopted to publish detailed information on members' arrears to the Fund.

Mr. Zecchini indicated that he supported the suggestion put forward by Mr. de Groote. At issue was not only a judgment about the "materiality" of the information to be published; there was also a question of the aims that the Fund wished to pursue by giving publicity to such information. In that respect, he had not heard much from his colleagues on the specific aims they wished to pursue by supporting a decision whereby information on arrears of individual members would automatically be published if the obligations in question were overdue by six months or more. His own preference was to disclose the names of individual countries once a decision had been adopted to declare the member ineligible to use the Fund's resources; and, even then, the decision to publish should be adopted with the clear understanding of what such publication was expected to achieve. Perhaps an additional staff paper clarifying those issues would be helpful.

Mr. Jayawardena stated that he too would prefer further discussion of the issue at hand. In any additional paper that might be prepared for such a discussion, he would like to see carefully stated the Fund's legal position with respect to publication of information on members' arrears to the Fund, not only in relation to the Articles of Agreement but also taking into account the sorts of promises of undertakings that might be given to countries in requesting detailed information from them. Furthermore, it would be useful if the staff could look more closely at the question of why commercial banks and central banks never revealed the details of their clients' arrears and never gave publicity to default cases.

Mr. de Groote added that it would also be helpful if the staff could examine the motivation behind the decision of the Bank for International Settlements not to publish data on the arrears of individual members.

The Chairman, commenting on the sense of the meeting thus far, said that the trend seemed to be toward publication of information on arrears to the Fund in aggregate in the quarterly financial statements, having in mind that such an approach was consistent with good accounting principles and gave recognition to the view of Directors that overdue payments might be material even if they were of a relatively small size.

The issue of whether or not to publish information on the arrears of individual member countries would be considered further before any decision was adopted, the Chairman continued. Future discussions would be based on existing staff papers and on the additional information requested by Mr. Dallara, Mr. Jayawardena, Mr. de Groote, and others. On the treatment of arrears in the Fund's financial statements, the preference seemed to be for an approach that would combine the flexibility of a judgment about the possible impact of overdue obligations on the Fund's financial position with a formula or guideline that could aid Directors in reaching a judgment about whether and to what extent it might be appropriate to adjust the net income target. That formula or guideline would have to be clarified before any firm decision on the matter was taken. In that regard, the approach suggested by Mr. Wicks, Mr. Dallara, and Mr. de Maulde of not counting unpaid charges as accrued income had not attracted much further support. In preparing further studies on possible formulas, the staff should look closely at Mr. Polak's suggestion for corrective charges and at Mr. Nimatallah's request to examine penalty charges.

Many different views had been expressed on the issue of "active" publicity in official Fund publications, although no strong support for that particular form of disclosure had been expressed at the present meeting, the Chairman observed. He would appreciate elaboration by Directors of the publicity issue at the next discussion, at which time the staff would provide several examples of how such disclosure might appear in different publications. Finally, there had not been a majority in favor of issuing a public statement or press release on the occasion of a declaration of ineligibility.

Mr. Nimatallah noted that the question of whether or not a press release should be issued on a declaration of ineligibility had not been among the topics for discussion put forward in EBS/83/231. In that respect, the lack of a majority in favor of issuing a press release might have had very little to do with Directors' views on the issue; his own feeling was that a press release was the only way to make a declaration of ineligibility meaningful.

Mr. Polak observed that on January 15 it was possible that Viet Nam would effectively be declared ineligible to use the general resources of the Fund. If there was no majority at the present meeting for issuing press releases when members were declared ineligible to use the Fund's resources, Directors could perhaps wait until January 15 to take the decision, which would then be related to a specific case.

Mr. Kafka remarked that the approach recommended by Mr. Polak might create a precedent that the Board later might not wish to follow. Any decision on whether or not a press release should be issued on the occasion of declarations of ineligibility should be taken on general grounds and not related to a specific case.

The Chairman then stated that he invited Directors to take a position on whether or not a press release should be issued when the Fund resorted to declarations of ineligibility.

Mr. Grosche recalled that he had already given his support to such an approach in an earlier intervention.

Mr. Jayawardena considered that because the issue being put to Directors was not an item on the agenda of the Executive Board, he was uncertain that it was appropriate to take a decision on it.

The Treasurer remarked that as he understood it, Directors had agreed at the November 19 discussion of the six-month report on overdue financial obligations to the Fund (EBM/84/167) to debate at the present meeting whether or not a press release should be issued to declare a member ineligible to use the resources of the Fund.

Mr. Zecchini considered that a press release should not automatically be associated with a declaration of ineligibility; rather, the matter should be decided on a case-by-case basis.

Mr. de Groote, Mr. Pérez, and Mr. Salinas said that they supported the ad hoc approach suggested by Mr. Zecchini.

Mr. Kafka said that he continued to feel that a special press release was unnecessary; moreover, with Mr. Zecchini's recommended approach, the failure to issue a press release in some cases might be misinterpreted as an effort to withhold information. Certainly there were many other less aggressive ways of making the international community aware that a member had been declared ineligible to use the Fund's resources. For example, a footnote in IFS should be sufficient.

Mr. Dallara said that as a general policy matter, he could support a carefully drafted press release that took into account the circumstances of the member and the facts that had brought the Executive Board to declare the member ineligible in the first place. While agreeing with Mr. Kafka that a press release was not necessary, he did feel that it was appropriate. On Mr. Zecchini's proposal, he observed that formal declarations of ineligibility should themselves be rare, and any judgment that a press release was warranted in some cases but not in others might be seen as inconsistent with the principle of uniformity of treatment.

Mr. Zecchini replied that there must be some way of making a distinction between those countries that were unable to repay and those that were unwilling to repay. He assumed that his colleagues would want to issue a press release only if it served some useful purpose, and he was not certain that it would do so if it were automatically issued upon declaration of ineligibility. It would be better to treat a press release as an additional step beyond the declaration of ineligibility and to employ it when it was helpful to the debt collection effort.

Mr. Grosche remarked that he was concerned also about the case-by-case approach to issuing a press release in connection with declarations of ineligibility. While circumstances of countries certainly differed, those differences would be taken into account in the discussion of whether or not to declare the member ineligible; once that determination was made, countries should be treated equally.

Mr. Jayawardena remarked that Directors should not come to a decision at the present meeting on whether or not to issue a press release in conjunction with declarations of ineligibility.

Mr. Wicks stated that he supported both Mr. Nimatallah and Mr. Jayawardena. While he continued to favor automatically issuing a press release when members were declared ineligible, the subject was a sensitive one deserving of further consideration. Perhaps the matter could be resolved at a later meeting on the basis of a further brief paper outlining the relevant principles.

Mr. Joyce and Mr. de Maulde said that they supported Mr. Wicks' proposal.

Following a further brief discussion, it was agreed that the Executive Board would return prior to January 15, 1985 to the issue of whether or not to publicize formal declarations of ineligibility in a press release. The discussion would be based on a short staff paper covering fairly broad questions of principle and policy.

2. INCOME POSITION FOR FINANCIAL YEAR 1985 - MIDYEAR REVIEW

The Executive Directors considered a staff paper on the midyear review of the Fund's income position for the financial year ending April 30, 1985 (EBS/84/235, 11/19/84; and Cor. 1, 11/21/84).

The Treasurer informed Executive Directors that the SDR interest rate, projected in EBS/84/235 to average 8.3 percent over the second half of the financial year, had declined to 8 percent by the second week of December. If the rate remained unchanged for the rest of the financial year, projected net income for the year as a whole would be of the order of SDR 43 million, compared to the estimate of SDR 34 million in the staff paper and the remuneration coefficient would increase from 88.33 percent of the SDR rate to 90 percent of the SDR rate for the quarter starting February 1, 1984. The remuneration expense would accordingly be higher than projected in EBS/84/235 for the last three months of financial year 1985.

Mr. Polak stated that he favored some immediate reduction in the rate of charge on the ground that the Executive Board had decided at EBM/84/85 (6/1/84) to reduce the rate of charge at the midterm review if net income for 1985 was estimated to be substantially in excess of the target. He was opposed to retroactively reducing the rate of charge at

the end of the financial year. Furthermore, the Executive Board should not decide at the present meeting to deem excess net income in financial year 1985 as income for financial year 1986 for the purpose of determining charges or to increase the target amount of net income for financial year 1985.

Mr. Grosche welcomed the indication in the staff paper that the Fund's net income for financial year 1985 was expected to be substantially in excess of target. Nevertheless, it would be premature and imprudent to consider reducing the rate of charge at present for a variety of reasons.

First, uncertainties remained regarding the estimate of the Fund's income for the remainder of the current financial year, Mr. Grosche noted. As the staff had pointed out, a relatively minor change in the SDR interest rate would affect actual net income and could even result in a deficit.

Second, the Executive Board should treat income projections cautiously, Mr. Grosche considered. The outcome for the first six months of financial year 1985 was a deficit of SDR 11 million rather than the projected surplus of about SDR 9 million, a margin of error of some SDR 20 million.

Third, the remuneration coefficient would be raised at the beginning of the coming financial year, and therefore, it was likely that the rate of charge would also need to be increased, Mr. Grosche said. It would not be advisable to lower the rate of charge at present given that it might need to be adjusted in the near future. To the extent possible, sharp fluctuations in the rate of charge should be avoided.

Fourth, the staff had indicated that the Fund's net income in 1985 might be lower than estimated by SDR 3 million owing to delays by members in paying charges and meeting repurchase obligations, Mr. Grosche remarked. Therefore, the Executive Board should be cautious in deciding on possible courses of action.

In sum, it was more reasonable to defer any decision on the distribution of excess income until the end of the financial year, Mr. Grosche stated. If at that time the Fund's actual income was substantially in excess of target, part of that excess could be deemed as income for financial year 1986 for the purpose of determining charges. However, the Fund's level of reserves was generally low and, in view of the increased incidence of overdue obligations, there was a case for strengthening the institution's reserve position.

Mr. de Maulde said that he agreed with Mr. Grosche that the rate of charge should not be reduced at present. However, he saw no difficulty in retroactively adjusting the rate of charge at the end of the financial year should net income be in excess of target.

Mr. Wicks commented that he would favor postponing any decision until the end of the financial year. Perhaps charges should be fixed on a quarterly basis to avoid increasing the rate of charge more than necessary.

Mr. Govindarajan noted that the Fund's net income for financial year 1985 was estimated to be SDR 34 million, or SDR 24 million in excess of the reserve target earlier agreed. He was disappointed that the paper did not provide a detailed trend analysis of the staff's projections of net income and the actual outcome over a period, as had been requested by his chair at the time of the work program discussion. Such an analysis would have shown clearly that the staff had been consistently underestimating the Fund's net income, resulting in a higher rate of charge than was necessary. He was aware of the difficulties in estimating precisely the Fund's net income because of the uncertainties surrounding key variables. However, he was concerned that the estimates always had tended to err in one direction. The Board should consider the matter further and adopt policies that would not place unnecessary and unfair burdens on borrowers who were facing a most difficult situation. Members who had been overcharged because of errors in the Fund's estimates of net income should be compensated when actual net income exceeded the reserve target, particularly given the recent decision to increase the rate of remuneration over the next few years, which would automatically have an adverse impact on the rate of charge. At EBM/84/85 his chair had opposed increasing the rate of charge beyond 6.89 percent, and the present net income projections supported his authorities' position that the rate of charge finally decided on had been too high.

In financial year 1984, the Fund's net income had totaled SDR 73 million, of which SDR 39 million--3 percent of reserves--would normally have been placed in reserves, Mr. Govindarajan recalled. However, SDR 61 million had been added to reserves, while SDR 22 million had been deemed as income for financial year 1985. At the beginning of the current financial year, the Executive Board had decided to consider at its midterm review of the Fund's income position a reduction of the rate of charge for the remainder of the year if net income was estimated to be substantially in excess of the target.

He did not agree with the staff statement on page 12 of EBS/84/235 that "during the first six months of financial year 1985, the Fund experienced an actual net deficit of SDR 11 million," Mr. Govindarajan commented. Footnote 2 on pages 4 and 5 of the staff paper indicated that deemed income for the first six months of financial year 1985 amounted to SDR 11 million. However, the entire SDR 22 million deemed from financial year 1984 should be taken into account in computing the Fund's income in the first six months of financial year 1985, in which case the Fund's income would have registered a surplus of SDR 11 million. While Rule I-6(4)(b) provided for the computation of actual income in the first six months on an annual basis, it did not imply that deemed income should be included on a pro rata basis throughout the year. The staff's calculation gave an erroneous impression that the safeguard mechanism should be activated on the basis of the income results of the first six months of the year.

The safeguard mechanism of Rule I-6(4)(b) was clearly asymmetrical, for it was activated only when Fund net income fell below 2 percent of the Fund's reserves and was not activated when Fund income exceeded the target, Mr. Govindarajan remarked. That asymmetry should be corrected to include automatic moderation of the rate of charge whenever Fund net income exceeded the target.

His chair had mentioned previously that as the rate of remuneration tended toward 100 percent of the SDR interest rate the additional expenses of the Fund would fall increasingly upon a limited number of borrowers, Mr. Govindarajan recalled. That argument applied equally to the buildup of reserves; with the present method of setting charges on a residual basis, any increase in the reserve target would have to be met increasingly by borrowing members only. It was, therefore, necessary to devise a formula whereby the annual increase in reserves was borne equally by all members of the Fund.

As for the various courses of action suggested by the staff, he agreed with the staff that there was no need to activate the safeguard mechanism at present, Mr. Govindarajan said. Furthermore, in keeping with the spirit of the understandings reached by the Executive Board earlier in the year the rate of charge should be immediately reduced to 6.76 percent. The staff estimate of excess income in financial year 1985 of SDR 24 million was based on the assumption that interest rates would remain at current levels. Interest rates could fall in the coming months, resulting in a sizable increase in the Fund's net income, a fact that strengthened the case for a decrease in the rate of charge at present.

He did not agree with the staff on the desirability of maintaining a relatively stable rate of charge as that principle was not being applied symmetrically, Mr. Govindarajan went on. Had the Executive Board ever decided against raising the rate of charge because of the desirability of avoiding fluctuations in the rate of charge?

The staff's suggestion that the disposal of any excess net income for financial year 1985 should be considered at the time of the annual review of the Fund's income position was not acceptable to him, Mr. Govindarajan remarked. The question of the effect of overdue obligations on the Fund's income should be taken up by the Executive Board at a later date as the Board had decided previously.

Mr. de Groote stated that the midyear review of the Fund's income position provided the Executive Board with an opportunity to foresee and possibly offset an income shortfall and to distribute excess income. Significant uncertainties regarding the use of the Fund's resources and, most important, the evolution of the market and SDR interest rates surrounded the staff's forecasts of the Fund's net income. Therefore, he did not favor an immediate reduction in the rate of charge, as the rate of charge might have to be increased at the beginning of financial year 1986 owing to the adjustment of the remuneration coefficient. Also, he noted from the staff's introductory statement that the remuneration coefficient had already increased.

If actual net income for financial year 1985 turned out to be much higher than the target, the rate of charge could be reduced retroactively or the net income in excess of target could be deemed as income for financial year 1986 for the purpose of determining charges, Mr. de Groote remarked. It was too early to express any preference at present. He did not support the suggestion to increase the target amount of net income in financial year 1985. The increase in overdue obligations should not be considered as a short-term liquidity problem, and there were good reasons for increasing the reserve target as a matter of general policy. But the Executive Board should consider the matter at the end of the present financial year.

Mr. Joyce stated that he did not favor a reduction in the rate of charge. He agreed with Mr. Grosche that the Executive Board should delay any decision on the disposal of any excess income until the end of financial year 1985 when the actual net income would be known.

Mr. Wang noted that despite the deficit of SDR 11 million in the first six months of the year, net income was estimated to be SDR 34 million for financial year 1985 as a whole, or SDR 24 million in excess of the net income target of SDR 10 million. Therefore, the safeguard mechanism of Rule I-6(4)(b) would not be activated.

He was in favor of reducing the rate of charge from 7 percent to 6.76 percent at present, Mr. Wang indicated. However, he could go along with the proposal to reduce retroactively the rate of charge at the next income review to the extent that realized net income for the year exceeded the target net income of SDR 10 million. He did not favor deeming any excess income at the end of financial year 1985 to financial year 1986 for the purpose of determining charges or placing excess income in the Fund's reserves.

Mr. Ainley remarked that in principle charges should be reduced if actual net income was substantially in excess of the agreed target. However, owing to the major uncertainties surrounding the projections for financial year 1985, particularly with respect to market interest rates and the effect of overdue obligations on Fund income, any decision on charges should be delayed until the end of the current financial year. At that time the various options for disposing of excess income could be considered. Also, the Executive Board should consider at a later date the question of overdue obligations and their effect on the Fund's income.

Mr. Zecchini remarked that in spite of the deficit registered in the first six months of the financial year, net income was expected to be larger than targeted at the end of financial year 1985. Given the numerous uncertainties surrounding the estimates, he did not favor lowering the rate of charge to 6.76 percent at present. The Fund's net income was only a small proportion of its operating income and was subject to relatively wide variations arising from minor changes in the underlying assumptions.

Furthermore, if the rate of charge were lowered at present, it might have to be increased at the end of the financial year to reflect the increase in the remuneration coefficient. Fluctuations in the rate of charge should be kept to a minimum.

If actual net income for financial year 1985 turned out to be substantially larger than targeted, the Executive Board would have the opportunity to decide either to reduce retroactively the rate of charge or to deem part of net income as income for financial year 1986, Mr. Zecchini noted. If the rate of charge were reduced at present, and net income for the year as a whole was below target, the Executive Board would be unable to take any corrective action at the next income review. A cautious approach seemed warranted. In sum, the rate of charge should be maintained, and any decision on the disposal of net income should be taken at the next income review when actual net income would be known.

Mr. Fujino commented that in view of the uncertainties underlying the projected net income, he did not favor a reduction in the rate of charge at present. He considered that excess net income for the year as a whole should either be deemed as income for financial year 1986 or be placed in the reserves, but a decision should not be taken until the next review of the Fund's income position.

Mr. Dallara considered that the rate of charge should be maintained at the current level for a variety of reasons. First, the midyear review was not an occasion for adjusting charges in the light of projected net income for the year, but was one to review the Fund's financial situation and to take action if it appeared that the income target for the year as a whole would not be met. Second, the net income position for the first six months of the year had not been as favorable as expected, while projections for the year as a whole indicated a more favorable income position than had been envisaged earlier. That fact underscored the precarious nature of the projections and the need for the Board to be cautious in placing heavy emphasis on projections in reaching any judgments at midyear. Estimates of the Fund's income position were subject to changes in interest rates and in the use of Fund resources. Third, the growing problems related to overdue obligations indicated the need for the Executive Board to be prudent at present.

Mr. Tvedt stated that he was concerned about the uncertainties surrounding the assumptions on which the net income projections had been based. Even a relatively minor deviation from assumed interest rate developments might have a major impact on the actual income of the Fund. For reasons of prudent financial management, no decision should be taken at present on the disposal of projected excess income, particularly given the large deficit in the first six months of the financial year. Furthermore, his chair attached great importance to achieving a reasonable degree of stability in the rate of charge. The uncertainty about an increase in the rate of remuneration favored postponement of the decision.

He favored maintaining the rate of charge at 7 percent for the rest of the financial year, Mr. Tvedt indicated. Stability in Fund charges might best be ensured by deeming excess income in financial year 1985 as income for financial year 1986. If, however, the SDR interest rate should decline further toward the end of the current financial year and overdue payments to the Fund had not worsened significantly, he was ready to consider a retroactive reduction in charges.

Mr. Pérez remarked that any decision should be taken with a view to ensuring an adequate net income for the Fund, while maintaining an appropriate level of charges for members using Fund resources. He recognized the difficulties faced by the staff in preparing estimates of the Fund's income for the second half of the year but noted a degree of conservatism regarding assumptions and projections. He was concerned about the staff's statement that it was desirable to "maintain stability in the rate of charge to the extent feasible," which implied that countries using Fund resources would have to pay a higher rate of charge at times than was necessitated by the Fund's net income position. As borrowing countries generally faced severe balance of payments and external liquidity problems, the costs of the policy of maintaining stability in the rate of charge could be high if that rate was out of line with the market rate of interest. He did not accept the argument that borrowing countries would be paying a lower rate of charge in the future that would compensate for those higher costs because the present value of external liquidity was greater at present than it would be in the future. Finally, his chair supported Mr. Polak's proposal to reduce the rate of charge modestly at present.

Mr. Kabbaj remarked that a reduction in the rate of charge at present would be in line with the understandings reached by the Executive Board at EBM/84/85, when it had been decided that the rate of charge would be reduced if revised estimates indicated a substantial excess income for financial year 1985. Furthermore, a reduction in the Fund's rate of charge would be a logical response to the recent downward trend in international interest rates and would send a strong signal to the financial community on the Fund's confidence about the continued improvement in the world economy. A failure to match the decline in the cost of borrowing from the market would result in a further erosion of the concessionality of the Fund's financial assistance.

Despite an improvement in the international environment, the difficulties facing the developing countries had abated only marginally, as reflected in the increase in overdue obligations, Mr. Kabbaj noted. He agreed with the staff on the desirability of avoiding frequent changes in the rate of charge, but not only when a reduction in the rate of charge was justified. In recent years, the rate of charge had been repeatedly increased in line with soaring international interest rates, and a decline in that rate was now called for. Additionally, it was inappropriate to argue that the rate of charge might need to be increased at the beginning of the coming financial year owing to the automatic increase in the

remuneration coefficient, which could well be offset by a further decline in market interest rates. For all those reasons, he favored a reduction in the rate of charge to 6.76 percent at present. A retroactive reduction of the rate of charge at the time of the next income review also would be appropriate, but it was hardly in line with the understandings reached by the Executive Board at EBM/84/85.

Mr. Finaish indicated his support for either a reduction in the rate of charge to 6.76 percent at present or a retroactive reduction in the rate of charge at the time of the next income review.

Mr. Romuáldez stated that the rate of charge should be left unchanged, and any decision on the disposal of net income should be considered at the time of the next income review.

Mr. Toé commented that he favored an immediate reduction in the rate of charge to 6.76 percent. However, should there be a majority in the Board favoring a retroactive reduction at the time of the next Fund's income review, his chair could go along with it.

Mrs. Sirivedhin recalled that the Executive Board had decided at EBM/84/85 to increase the rate of charge from 6.7 percent to 7 percent effective May 1, 1984 in order to generate a net surplus of SDR 10 million. Revised estimates indicated that the Fund's net income in financial year 1985 would be SDR 34 million, 240 percent above the net income target agreed at the beginning of the financial year. That excess was substantial enough for the Executive Board to agree to a reduction in the rate of charge from 7 percent to 6.76 percent. Such action would be justified for a variety of reasons.

First, estimates of the Fund's income position had proved to be wrong, and the review was an appropriate time to change decisions that had been made on erroneous estimates, Mrs. Sirivedhin noted. Charges should be adjusted symmetrically, whether in response to a projected deficit or surplus. The staff recommended against reducing charges at present because of the uncertainties regarding the estimates. Uncertainties had always existed, even six months previously when charges had been increased, and they should not be used as a reason for not reducing charges.

Although the staff had suggested that the rate of charge could be reduced retroactively at the end of the financial year, that option was unrealistic owing to practical difficulties in reaching such a decision in the Board and because of difficulties of implementation, Mrs. Sirivedhin stated. Even if net income at the end of financial year 1985 were in excess of target, the Executive Board might not decide to reduce charges retroactively.

She considered it unfair for the Fund to adopt policies that in effect required debtor countries to contribute to the accumulation of the Fund's reserves and to pay for the operating costs of the institution,

particularly when the world financial community and the debtor countries were concerned about debt servicing problems and when debtors were undertaking severe adjustment measures to alleviate their difficulties, Mrs. Sirivedhin commented. The Fund's reserves had been growing at an average rate of 8 percent a year in the past six years, compared with a target growth of 3 percent a year. The present rate of charge, which had been set at too high a level owing to estimation errors at the beginning of the current financial year, should be lowered.

Mr. Arias indicated his support for the various courses of action proposed by the staff on page 12 of EBS/84/235.

Mr. Munthali stated that he shared the views expressed by Mr. Govindarajan. The staff had emphasized that the projected net income for financial year 1985 was subject to a number of uncertainties regarding interest rates and the use of Fund resources. He was disappointed that the Fund did not have a more precise idea of the possible use of Fund resources by member countries.

He favored an immediate reduction in the rate of charge to 6.76 percent, Mr. Munthali indicated. The question of strengthening the Fund's reserves to take account of the increasing incidence of overdue obligations should be considered at a later date. The safeguard mechanism of Rule I-6(4)(b) also should be activated to reduce the rate of charge at the time of the midyear review of the Fund's income position if net income was projected to exceed the targets substantially.

Mr. Salinas commented that he supported a modest reduction in the rate of charge at present and a retroactive reduction in the rate of charge at the end of the financial year should the Fund's net income exceed the 3 percent reserve target substantially.

The Treasurer noted that, in fact, the staff did not always err on one side when estimating the Fund's net income. It had reviewed its estimates of the Fund's net income and had found that in three out of eight cases the Fund's net income had been underestimated. On each of those occasions, the margin of error had been small. For the present exercise, the actual outcome of the first six months of financial year 1985--a deficit of SDR 11 million--compared with projected operational income of about SDR 1 billion, represented a significant margin of error.

The staff's estimates of net income were strongly influenced by the underlying assumptions, which the staff found difficult to improve upon, the Treasurer considered. A variety of reasons explained previous errors in estimation. In 1982, the actual net income had been less than the staff's estimates because of the shortfall in the use of the Fund's ordinary resources. In 1983, market interest rates had declined, resulting in higher than projected net income. In 1984, actual net income had been less than projected income mainly because of the fluctuations in the SDR interest rate to which the rate of remuneration was linked.

A question had been raised whether the staff's method of estimating the actual deficit for the first six months of financial year 1985 had been appropriate, the Treasurer recalled. The deficit of SDR 11 million represented the difference between the Fund's operational income and its operational expense. The Executive Board had decided at the end of financial year 1984 to deem a part of the 1984 excess income as income for financial year 1985 for the purpose of determining charges, which would otherwise have had to be higher than 7 percent to achieve the agreed net income target. The staff had treated one half of that excess income as income for the first six months of financial year 1985 and one half as income for the second six months of that year.

The Fund had never attempted to apply a particular category of income to a particular category of expense, the Treasurer indicated. The debtor members were not solely responsible for paying the Fund's administrative expenses nor for adding to the Fund's reserves; they were sharing that burden with other member countries. The amount of income that was placed to reserves depended on a combination of factors, including income from charges, expenditures reflecting the below-market rate of remuneration, and the amount of interest-free resources available to the Fund.

The staff had no preconceived ideas on the desirability of avoiding frequent changes in the rate of charge, the Treasurer remarked. In fact, the staff had suggested in previous years that one way to improve the consistency between the expected and actual net income would be to adjust charges more frequently. That option had been rejected by the Executive Board. A more stable rate of charge allowed debtor countries to be more certain of their financial position; they would not be subjected to unforeseen changes in the market interest rate. On two occasions the Executive Board had decided against raising charges by as much as would have been necessary to meet the target income in order to contribute to the stability of charges.

The Director of the Legal Department commented that the proposed treatment of the excess 1984 income that had been deemed to 1985 financial year income was consistent with the Rules of the Fund.

Mr. Govindarajan stated that he had never referred to the staff's estimates as being based on biased assumptions. Nevertheless, the Fund's reserves had been accumulating at a much greater rate than the target of 3 percent a year, indicating that the estimates had been consistently conservative. He had also noted that the Executive Board had decided to raise the rate of charge on previous occasions because of imprecise estimates, and applying the same logic of imprecise estimates, it was appropriate to reduce the rate of charges. Finally, he had not stated that the borrowing countries would bear the entire burden of an increase in the Fund's expenses or reserves. Rather, the borrowers' share of the burden would be increasing as the rate of remuneration increased.

The Chairman noted that a majority of Executive Directors was in favor of maintaining the current rate of charge. The Executive Board would consider the question of the disposal of net income at the next review of the Fund's income position.

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/84/185 (12/17/84) and EBM/84/186 (12/17/84).

3. PORTUGAL - STAND-BY ARRANGEMENT - WAIVER OF PERFORMANCE CRITERION

1. Portugal has consulted with the Fund in accordance with paragraph 4 of the stand-by arrangement for Portugal (EBS/83/196, Sup. 1, 9/13/83) as modified by Executive Board Decision No. 7769-(84/116) of July 30, 1984 and paragraphs 18 and 10 of the letters dated September 9, 1983 and June 20, 1984, respectively, from the Minister of Finance and Planning and the Governor of the Bank of Portugal.

2. The cable dated December 5, 1984 from the Minister of Finance and Planning and the Governor of the Bank of Portugal shall be attached to the stand-by arrangement for Portugal and the letter dated June 20, 1984, attached to the stand-by arrangement, shall be read as modified by the cable of December 5, 1984.

3. The Fund finds that, in the light of the attached cable dated December 5, 1984, no additional understandings are necessary and that Portugal may proceed to make the next scheduled purchase under the stand-by arrangement.

Decision No. 7875-(84/186), adopted
December 17, 1984

APPROVED: September 30, 1985

ALAN WRIGHT
Acting Secretary