FOR AGENDA

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CONFIDENTIAL

December 22, 1983

To: Members of the Executive Board

From: The Acting Secretary

Subject: Methods for Determining the Rate of Remuneration

The attached paper on methods for determining the rate of remuneration has been scheduled for discussion by the Executive Board tomorrow, Friday, December 23, 1983.

Att: (1)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

Methods for Determining the Rate of Remuneration

Prepared by the Treasurer's Department

Approved by W.O. Habermeier

December 22, 1983

The following paragraphs deal with the various methods suggested at Executive Board Informal Session 82/3 of how to raise the rate of remuneration in relation to the SDR rate of interest.

Method 1

The rate of remuneration in relation to the SDR rate of interest (hereafter also called "remuneration coefficient") would be raised as conditions permit. As a first step, the rate of remuneration would be raised from 85 percent to [ ] percent of the SDR interest rate with effect from [January] [May] 1, 1984. Further increases in the coefficient would be considered in the framework of semiannual reviews of the Fund's income position under Rule I-6(4).

A summary of the financial implications of an increase in the rate of remuneration in specified proportions of the SDR interest rate in FY 1985 is discussed in "The Rate of Remuneration and the Fund's Income Position" (EBS/83/237, 11/2/83), pp. 14-15.

Method 2

The rate of remuneration would be raised over time to equality with the SDR rate of interest. As a first step, the rate of remuneration would be increased from 85 percent to [ ] percent of the SDR interest rate with effect from [January] [May] 1, 1984. Further increases in the coefficient would be considered in the framework of semiannual reviews of the Fund's income position under Rule I-6(4).

The fact that an objective of equality would be established may also have implications for the size of the increase in the remuneration coefficient in the first year and thus the financial implications for FY 1985 may not be the same as under the method summarized in the previous paragraph.

Method 3

The rate of remuneration would be raised to equality with the SDR interest rate in equal steps at fixed intervals to be completed in a specified period of time. The suggestions made by Executive Directors included increases in the coefficient at monthly, quarterly, semiannual,

and annual intervals; equality with the SDR interest rate would be achieved over a period of one year, two and a half years, or five years.

The financial implications for FY 1984 and FY 1985 are shown in Table 1.

Table 1. Increase in the Remuneration Coefficient and the Rate of Charge Necessary to Meet Net Income Target, FY 1984 and FY 1985

	Remuneration Coefficient Raised Over					
	One-Year		Two and a Half Years		Five Years	
Date	Rate of remuneration as percent of SDR interest rate	Rate of charge	Rate of remuneration as percent of SDR interest rate	Rate of charge	Rate of remuneration as percent of SDR interest rate	Rate of charge
(1)	(2)	(3)	(4)	(5)	(6)	(7)
Jan 1, 1984	87)		87.5			
Feb 1, 1984	88)	6.6		6.6		
Mar 1, 1984	89)					
Apr 1, 1984	90)					
* *						
May 1, 1984	91)	8.0		7.5	88	7.2
Jun 1, 1984	92)					
Jul 1, 1984	93)		90			
Aug 1, 1984	94)					
Sep 1, 1984	95)					
Oct 1, 1984	96)					
Nov 1, 1984	97)					
Dec 1, 1984	98)					
Jan 1, 1985	100)		92.5			

Note: Estimates for use of the Fund's resources and attendant charges have, for a variety of reasons (including that access limits to the Fund's resources have been agreed only for 1984), been confined to FY 1984 and FY 1985.

Variant A: A variant of the method of linear increases in the rate of remuneration to equality with the SDR rate would be to accelerate the increase in the remuneration coefficient when there is a decline in the SDR interest rate. One suggestion was to increase the remuneration coefficient over a five year period by 3 percentage points at the beginning of each financial year, from May 1, 1984, with an additional increase of 1 percentage point thereafter for each 1/10 percentage

point that the SDR interest rate in the last week of the financial year is below the rate of the last week of the previous financial year. Another possibility mentioned would be to apply the system mutatis mutandis to the regular monthly increases shown in column 2 above. It would have to be decided whether the same acceleration factor should be applied. The principle of linking changes in the remuneration coefficient to changes in the SDR interest rate could be applied analogously to the short period, shown in column 2 of Table 1, by lengthening that period when the SDR interest rate increased during the period.

Variant B would be to shorten the period over which it was initially intended to achieve equality, but would call for a change of the predetermined increase in the rate of remuneration only when the SDR rate of interest increases or decreases from the level at the beginning of the period by more than a specified percentage as shown in Table 2:

Table 2. Increase in the Remuneration Coefficient
(In percentage points)

Date	SDR interest rate unchanged (1)	SDR interest rate sharply higher (2)	SDR interest rate sharply lower (3)
Jan 1, 1984	+3.75	+3.75	+3.75
Jul 1, 1984	+3.75	+3.75	+3.75
Jan 1, 1985	+3.75	+2.5	+7.5
Jul 1, 1985	+3.75	+2.5	
Jan 1, 1986		+2.5	

For example, if the SDR interest rate rose by, say, 5 or 10 percent (or more) during the first year of the adjustment period, the last two semiannual increases of 3.75 percent each might be replaced by three semiannual increases of 2.5 percent, which would lengthen the period to achieve equality from 18 to 24 months (column 2). On the other hand, if the SDR interest rate declined by the specified amount--5 or 10 percent or more--the last two semiannual increases would be combined into one increase of 7.5 percentage points, achieving equality in 12 months instead of 18 months.

The corresponding rates of charge required to meet the income target for the remainder of FY 1984 and in FY 1985 are as follows:

Table 3. Rate of Charge in FY 1984 and FY 1985

	FY 1984	FY 1985
SDR interest approximately unchanged	6.6	7.7
SDR interest rate 10 percent higher	6.6	7.9
SDR interest rate 10 percent lower	6.6	7.6

The timing of the slowdown or acceleration could take other forms but the method would rapidly become overly complex. A 10 percent change of the SDR interest rate year-on-year would appear substantial, taking the last decade or so as a whole.

Method 4

The remuneration coefficient would be raised periodically over time to 100 percent of the SDR interest rate, subject to the condition that the increase in the coefficient would not of itself give rise to an increase in the current rate of charge of 6.6 percent. This would, of course, not preclude increases in the rate of charge that might be decided for reasons other than an increase in the remuneration coefficient. The period required to reach equality between the rate of remuneration and the SDR interest rate, as well as the timing of increases in the rate of remuneration relative to the SDR interest rate, cannot be defined because it depends on market interest rate developments and other factors affecting the Fund's income position. The order of magnitude that might be involved can be illustrated by the following: if the SDR rate would fall by one percentage point from its present level (i.e., to 7.80 percent) and all other things remained equal, the rate of remuneration could rise to 6.98 or 89.5 percent of the SDR rate. It is the staff's understanding that an increase in the remuneration coefficient subsequent to a decline in the SDR interest rate would not be reversed should the SDR interest rate rise later.

Method 5

The suggestion was also made to adjust the remuneration coefficient up to 100 percent in line with declines in the SDR interest rate from the preceding review date. Like Method 4, this method leaves the date of reaching equality uncertain. However, provided the increase in the remuneration coefficient is not reversed, and the adjustments in the coefficient are relatively frequent, say, monthly or quarterly, in

response to declines in the SDR interest rate from the end of the preceding month or quarter, then substantial adjustment may take place over a reasonably short period say in the order of 1 1/2 to 2 1/2 years.

If this method were to be combined with Method 4, it would be necessary to decide whether or not changes in the Fund's net income position and charges not resulting from a change in the remuneration coefficient, should be precluded.

Method 6

The remuneration coefficient would be increased or decreased within the leeway provided by the Articles (i.e., between 80 percent and 100 percent of the SDR interest rate) in order to maintain the concessionality in the use of the Fund's ordinary resources at an agreed level. Under this method, the rate of charge would be set in such a way as to maintain an agreed grant element as a measure of concessionality which, as indicated by the Managing Director in Informal Session 83/2, could be computed in a number of ways. With a given reserve growth target, the rate of remuneration would be the residual parameter that would need to be adjusted in order to reach the net income target. The remuneration coefficient would be related directly to the SDR interest rate, and vary inversely with the use of Fund credit and the size of remunerated positions. Two calculations under this method with grant elements of 5 percent and 10 percent, based on the SDR interest rate as proxy to an appropriate discount rate for calculating the grant element and on the projections of use of Fund resources for FY 1985, are shown in Table 4.

As can be seen from Table 4, with the present level of use of Fund credit and remunerated positions, it would not be possible to maintain a grant element (computed in relation to the SDR interest rate) of 10 percent when the SDR interest rate is below about 11.5 percent, as it would require a rate of remuneration of less than 80 percent of the SDR interest rate. A remuneration coefficient of 100 percent would not be reached unless the SDR interest rate rose significantly beyond 15 percent or the outstanding use of Fund credit financed from ordinary resources and corresponding remunerated balances contracted sharply.

Table 4. Rate of Charge and Rate of Interest at Various SDR Rates of Interest with Given Grant Element, FY 1985

SDR interest rate	Grant Element of 5 Percent 1/				Grant Element of 10 Percent 1/			
	Rate of Charge		Rate of Remuneration		Rate of Charge		Rate of Remuneration	
	Percent	Percent of SDR interest rate	Percent	Percent of SDR interest rate	Percent	Percent of SDR interest rate	Percent	Percent of SDR interest rate
6.0	4.7	78.3	4.9	81.7	3.4	56.7	3.7	61.7
7.0	5.7	81.4	6.0	85.7	4.4	62.9	4.8	68.6
8.75	7.4	84.6	7.9	90.3	6.0	68.6	6.6	75.4
10.0	8.6	86.0	9.1	91.0	7.2	72.0	7.9	79.0
12.5	11.0	88.0	11.8	94.4	9.5	76.0	10.4	83.2
15.0	13.4	89.3	14.4	96.0	11.8	78.7	12.9	86.0

1/ The "grant element" in this table is calculated as the face value of a commitment less the discounted present value of the future flow of payments of principal and interest expressed as a percentage of the face value, using the SDR interest rate as discount rates.