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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 83/176

10:00 a.m., December 19, 1983

J. de Larosière, Chairman
W. B. Dale, Deputy Managing Director

Executive Directors	Alternate Executive Directors
	W. B. Tshishimbi
	L. E. J. M. Coene, Temporary
B. de Maulde	X. Blandin
	J. Delgadillo, Temporary
R. D. Erb	
M. Finaish	T. Alhaimus
T. Hirao	
J. E. Ismael	Jaafar A.
R. K. Joyce	L. Leonard
	C. Robalino
	G. Grosche
G. Lovato	C. P. Caranicas
R. N. Malhotra	A. S. Jayawardena
Y. A. Nimatallah	J. E. Suraisry
J. J. Polak	
A. R. G. Prowse	
G. Salehkhou	O. Kabbaj
F. Sangare	
	J. L. Feito
J. Tvedt	A. Lindø
N. Wicks	T. A. Clark
Zhang Z.	Wang E.

A. Wright, Acting Secretary
J. C. Corr, Assistant

Also Present:
Asian Department: J.-P. C. Golle. European Department: V. Marie. Exchange and Trade Relations Department: D. K. Palmer, Associate Director. External Relations Department: H. O. Hartmann. Legal Department: G. P. Nicoletopoulos, Director; Ph. Lachman, J. M. Ogoola, S. A. Silard. Middle Eastern Department: F. Drees, S. Thayanithy. Research Department: R. R. Rhomberg, Deputy Director; N. M. Kaibni, P. R. Menon, E. A. Milne, H. H. Zee. Treasurer's Department: W. O. Habermeier, Counsellor and Treasurer; D. Williams, Deputy Treasurer, D. H. Brown, S. I. Fawzi, R. B. Hicks, B. E. Keuppens, J. T. McDonald, T. M. Tran, G. Wittich. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: S. R. Abiad, E. A. Ajayi, H. A. Arias, C. J. Batliwalla, S. E. Conrado, L. K. Doe, S. El-Khouri, K. A. Hansen, S. M. Hassan, W. Moerke, Y. Okubo, I. R. Panday, P. D. Péroz, D. I. S. Shaw, D. C. Templeman. Assistants to Executive Directors: E. M. Ainley, H. Alaoui-Abdallaoui, J. Bulloch, M. Camara, M. B. Chatah, R. J. J. Costa, G. Ercel, V. Govindarajan, D. Hammann, J. M. Jones, A. K. Juusela, H. Kobayashi, M. J. Kooymans, M. Rasyid, A. A. Scholten, Shao Z., S. Sornyanyontr, Wang C. Y., A. Yasseri.

1. RATE OF REMUNERATION AND FUND INCOME POSITION

The Executive Directors continued from the previous meeting (EBM/83/175, 12/16/83) their consideration of a staff paper on the rate of remuneration and the Fund's income position (EBS/83/237, 11/2/83).

Mr. Leonard stated that EBS/83/237 contained a welcome factual analysis of the issues before Executive Directors, about which his chair had expressed concern on a number of occasions. At EBM/83/172 (12/14/83) and at EBM/83/70 (5/16/83), his chair had urged consideration of the need to promote reserve positions in the Fund as valuable assets in the reserve portfolios of Fund creditors. The staff had made it clear that, after the revised and enlarged General Arrangements to Borrow (GAB) became effective, reserve tranche positions would be the only creditor claims on the Fund that yielded a rate of return significantly below market-related rates of interest, even though they were less liquid than other Fund-related assets. Therefore, he supported raising the yield on reserve tranche positions to bring it into line with those other assets, which would require raising the rate of remuneration to 100 percent of the SDR rate.

Increasing the rate of remuneration would serve to facilitate the financing of the Fund from quotas on the scale likely to be needed for some time ahead, Mr. Leonard considered. He agreed with the staff that, in line with the reserve character of remunerated positions, frequent variations in the rate of remuneration relative to the SDR rate were better avoided in order both to protect the Fund's income position and to ensure acceptable compensation to creditors. He could support the alternative of greater variations in the Fund's reserve targets or in the level of charges or of both.

His chair was sensitive to the burden of charges on debtors, Mr. Leonard continued, and he was open to consideration of proposals to soften the effects of raising the level of remuneration. However, the primary interest of borrowers at present, and for some time to come, would be best served by their having adequate ordinary resources of the Fund to draw on in financing their balance of payments needs. He doubted that it would be possible to ensure the availability of financing, having regard to present conditions and thinking in financial markets, unless the holding of Fund-related assets were reasonably attractive and the Fund's reputation for realism and balance as a market agent were maintained. On both counts, it was inevitable that sooner or later a rise in the rate of remuneration would be accompanied by a rise in charges.

Even with a rise in charges, a degree of concessionality would remain because the combined market rate was generally below the rate of return that could be gained by investing in individual currency markets, and it was well below alternative lending rates facing borrowers, Mr. Leonard observed. There was also some force in the argument that there was a need in present circumstances to reduce excessive incentives to members to finance a disproportionate share of external deficits from Fund resources.

Commenting on the question of the timing of changes in both the rate of remuneration and the rate of charge, Mr. Leonard said that the present would be appropriate. He preferred to increase the rate of remuneration to 100 percent of the SDR rate and to raise the rate of charge to 8.33 percent if that rate were the one considered necessary to prevent the emergence of a deficit in the Fund's income position. Such action could be delayed until the beginning of the next financial year on May 1, 1984. Otherwise, he could accept a phasing of the increases as suggested by the staff in paragraph (iii) on page 14 of EBS/83/237. While the latter option was less desirable, it would result in a rate of remuneration equal to the SDR rate at least by FY 1985. The two-stage approach within FY 1984 was preferable to phasing the increase over two financial years, but he recognized that an increase in the rate of charge might be more acceptable to many users of Fund resources if it were phased over a longer period. However, phasing the increase in charges according to projected developments in the Fund's income position did not appear to be feasible because of the difficulty of targeting income.

Mr. Hirao commented that the argument in EBS/83/237 in favor of the case for raising the rate of remuneration to the level of the SDR interest rate was persuasive. In exchange for the free use of their currencies, the creditor countries obtained reserve tranche positions or SDRs. For an increased reserve position, they were paid the rate of remuneration, while for an increase in SDR holdings, they were paid the SDR interest rate. It was difficult to find a convincing argument for the difference between the two situations; indeed, given the less liquid nature of the reserve tranche position, there was a valid argument for remunerating that asset more favorably than SDR holdings.

There should be some degree of concessionality in charges, Mr. Hirao continued, in order to induce member countries to adopt corrective measures at an early stage. However, in view of the Fund's main function--to assist member countries to overcome their balance of payments difficulties--concessionality should be limited. Fund financing was of a temporary, revolving character; it was not supposed to constitute a transfer of resources. It would be reasonable for the concessional element in charges to be limited to the level that could be derived from interest-free resources, which were common assets of all members.

The pressing need to finance further increases of Fund credit by expanding the total of reserve tranche positions provided another justification for raising the rate of remuneration, Mr. Hirao considered. Given the fact that quotas were the Fund's principal resources, and given the strong possibility that the next quota increase would be of great importance in coping with the continued debt problems, it would be essential to give prudent and appropriate consideration at present to eliminating, or at least minimizing, the possible obstacles to the vitally needed increases in quotas in the coming years.

Due consideration should be given to alleviating the short-run impact on the rate of charge, Mr. Hirao added. Among the several options put forward, he supported a progressive rise in the rate of remuneration, that would raise the rate by 5 percent, in three steps beginning in May 1984 and ending about a year later, a reasonable period of time. Financial soundness was central to the Fund's operations in the coming decade. Raising the rate of remuneration to a competitive level would be an important step, in conjunction with other possible measures, toward enhancing the soundness of the financial structure of the Fund, and it would be in the best interests of all members.

Mr. Lovato remarked that the problem before Directors was important, and a flexible solution should be considered, as Mr. de Maulde had suggested during the discussion on the Fund's income position (EBM/83/172 and EBM/83/173, 12/14/83), without complicating it with linkages to other matters on which the Board had already found a compromise. The staff had provided a useful broad analysis of the problem with a balanced exposition of the pros and cons of the different solutions. In general, he agreed that the rate of remuneration could be adjusted toward the return on other Fund-related assets, for all the reasons put forward by the staff. However, an increase in the rate of remuneration would imply an increase in charges sooner or later in order to maintain the Fund's reserves at a reasonable level.

In that context, there were two reasons to doubt the wisdom of increasing substantially the rate of remuneration at present or in the short term, Mr. Lovato continued. First, if the rate of remuneration and charges were raised to, or close to, the level of market rates, could the Fund continue to be considered a cooperative institution and could it expect member countries in balance of payments need to come to it instead of going to the market, if and when possible? Second, leaving aside general considerations, the Executive Board had to consider with particular care under what conditions an increase in the rate of charge could be sustained at present by the debtor countries, which were already heavily burdened and which might find it difficult, or even impossible, to meet stronger conditions.

In sum, he did not question the technical reasons for an increase in the rate of remuneration, Mr. Lovato said. Indeed, he agreed in principle with the proposal to bring it, gradually, more into line with the return on other Fund-related assets. The argument for such action could not be dismissed, but he agreed with Mr. de Maulde that at the present particular moment the Fund should go along with, perhaps even take the lead in, actions to reduce the interest rates paid by debtor countries. Therefore, his authorities did not favor a substantial increase in the rate of remuneration at present; as a compromise, they could accept a modest increase of up to 90 percent of the SDR rate, and they were prepared to review the matter at an appropriate time in light of all the relevant circumstances.

Mr. Zhang noted that an increase in the rate of remuneration to the level of the SDR interest rate would, in current circumstances, necessitate an increase in the rate of charge in order to maintain the Fund's income position. Such an increase would, in turn, have an unfavorable impact on the present concessional element in Fund charges. Action of that sort would be most undesirable and would create hardships for the borrowing countries at the present difficult time. Therefore, an increase in the rate of remuneration should not be considered at present.

Mr. Delgadillo commented that the Chairman had correctly stated in his summing up of the Executive Board's previous discussion of the Fund's income position (EBM/83/70, 5/16/83), that a number of important decisions such as the frequency of interest rate payments on SDRs, remuneration, enlarged access policy, and the level of reserves were closely linked and would affect the Fund's income position. The present discussion on the rate of remuneration could not be isolated from the other interrelated issues that the Chairman had mentioned. It would have been preferable if all the relevant factors could have been discussed together in a balanced way.

Commenting on the specific issues in EBS/83/237, Mr. Delgadillo noted that Table 3 had been constructed to illustrate the impact of modifications in market rates of interest on the projected deficit in the Fund's income position. Other things remaining equal, wide fluctuations in interest rates could have a marked effect on the Fund's financial situation, but there were other similarly important variables that were equally difficult to predict, such as the volume of credit extended by the Fund. Assumptions other than those used in the tables were possible, such as less variability in interest rates and different levels of Fund credit. In other words, given the uncertainties regarding the variables that would have a favorable or unfavorable impact on the Fund's finances, it would be reasonable to construct a flexible scheme that constituted a gradual and cautious approach.

He agreed with the staff's view that charges should be set at a level to encourage members to make early use of the Fund's resources, Mr. Delgadillo continued. However, he was not convinced of the validity of the other two arguments put forward by the staff, namely, that a low rate of charge would discourage members from making repurchases, or that it would induce countries to finance an undue share of their deficit. After all, the Fund had the necessary safeguards and instruments to persuade countries not to do so. Furthermore, the argument that "in the past, the rate of charge was suggested in the light of increases in interest rates in the major international centers" might give the wrong signal to the rest of the financial community.

He also agreed with the staff that an increase in the rate of remuneration relative to the SDR interest rate and, hence, to the market rate of interest would reduce the element of concessionality, if the rate of charge were modified accordingly, Mr. Delgadillo remarked. However, it need not be assumed that a change in the rate of charge would be automatic or inevitable. In assessing the repercussions of an increase in the rate of remuneration, Directors had to give adequate consideration to the impact of such action on the use of Fund credit. The extremely serious financial difficulties currently being faced by debtor countries constituted a highly restrictive factor to be taken into account. In view of the projected increase in the use of Fund resources, the average cost for debtor countries would be higher because the Fund would continue to have to borrow despite the recent increase in quotas. Therefore, under the present circumstances, it would be inappropriate to increase the rate of remuneration if such an increase required a compensatory increase in the rate of charge.

Mr. Jaafar said that Mr. Malhotra's remarks at EBM/83/175 (12/16/83) on the rate of remuneration and the Fund's income position had touched on a basic issue surrounding the present subject and others that came before the Executive Board. Mr. Malhotra's concern had been over the need for the staff to try to preserve neutrality in its presentation. In the case before Executive Directors, he had argued that only one point of view--that of the creditors--had been put forward. If true, such a situation destroyed the basic principle of uniformity of treatment that the Fund upheld.

If the rate of charge and the role of remuneration could be changed together to meet an income target or reserves target, Mr. Jaafar continued, the position would be straightforward. However, such a model was too simplistic. It ignored the fundamental premise implicit in EBS/83/237 and other related papers that remuneration and charges had to reflect market rates or, in the present context, the rates on SDRs, which were, in turn, based on a combination of market rates. That assumption had constituted the essence of the approach taken by the staff in EBS/83/237 and other papers; under it, the reward for lending and the cost of borrowing would somehow have to be brought into line with the market. The assumption also accounted for the situation that had developed in 1982, when net income had been significantly overestimated but no consideration had been given to rolling back the rate of charge. On the other hand, if a deficit had been projected, charges would have been raised, as required by Rule I-6(4)(b). Adjustment downward of the rate of remuneration was almost never considered. Such a position would be valid only if it were accepted that both borrowing and lending ought to reflect the market. Because both charges and remuneration were at present below market rates, the direction of adjustment would only be upward.

The call for an increase in the rate of remuneration--to reflect the market fully--ignored the other basic premise that the Fund was a cooperative body, a point that other Directors had made at EBM/83/175 and at the present meeting, Mr. Jaafar considered. That premise went beyond membership in the Fund; it was basic to trade among nations. Members that were fortunate enough to have balance of payment surpluses were necessarily obliged to help those members in deficit within the context of the Fund's programs. Directors should not forget that, in principle, a balance of payments surplus in one country could only occur at the expense of another country. Precisely such a concept of burden sharing was the basis for the requests, sometimes made by a country forced to devalue, for its major trading partners to appreciate their currencies correspondingly. However, such action seldom occurred in practice: the burden of adjustment almost always fell on the weaker partner. The problem under discussion was, in principle, analogous. The pressure to adjust and to bear the cost of adjustment always fell on the weaker members of the Fund.

A middle position was required, Mr. Jaafar suggested. At EBM/83/175, Mr. de Maulde had offered an alternative that appeared painless, i.e., that the rate of remuneration should be increased pari passu with the SDR rate only when the SDR rate was declining. He tended to agree with Mr. de Maulde's proposal, but with some exceptions. In conformity with the spirit of international cooperation, the rate of remuneration ought not to be allowed to increase to 100 percent of the SDR rate. Furthermore, the cost of financing the expected income position should fall on both charges and remuneration. While both charges and remuneration would have to reflect the market in a limited way, the case should not be overstated. He agreed with those Directors who had noted that the rate of remuneration had increased sharply from 35 percent of the SDR rate in 1974 to 85 percent at present. Such an increase was large indeed; abruptly to increase it further would not be in keeping with the image of the Fund. It would trigger an immediate demand for an increase in charges at a time when many members were badly hit by recession and when the demands for Fund resources in support of adjustment were unprecedented in the history of the institution.

The need for a further increase in remuneration and, consequently, in charges should be carefully reviewed, Mr. Jaafar went on. The proposal came at a period soon after the quota exercise had proved to be inadequate to supplement the Fund's resources and when conditionality and access to the Fund's facilities and resources had been tightened. Any significant rise in either remuneration or charges at present would be more than was necessary. It could lead to a misperception that members in deficit positions, badly in need of adjustment and assistance, were being treated differently and discriminated against in comparison with those members with balance of payments surpluses that were Fund creditors. Of course, such a perception would be unwarranted, because the Fund was bound by the principle of uniformity of treatment of members. Nonetheless, the Executive Board should try to prevent such an impression from arising.

Mr. Coene recalled that for some time his chair had maintained that Fund-related assets, meaning both reserve positions in the Fund and SDRs, ought to bear the same rate of return. That view had been reinforced by the arguments in EBS/83/237. His authorities generally believed that reserve tranche positions in the Fund were not as usable as other kinds of reserve assets. That position was, moreover, the basis for their contention that the rate of remuneration for those assets should be raised to 100 percent of the interest rate of the SDR, or at least closer to that rate than at present, in order better to reflect the reserve character of the reserve tranche position compared with other reserve assets. Even if the rate of remuneration were raised to 100 percent of the SDR rate, the return that it would yield would remain lower on average as long as the norm remained below the quota level. In view of the growing share of reserve positions in the Fund in total reserves, an increase in the rate of remuneration was warranted in order to maintain members' willingness to contribute further to financing the Fund's operations.

However, in increasing the rate of remuneration, Mr. Coene continued, the Executive Board ought also to heed the impact that such an increase would have on the rate of charge and thereby on the level of concessionality, an essential element in the cooperative nature of the institution. The impact on the Fund's financial position also had to be taken into account. If the increase were made in one step, the rate of charge would have to rise to 8.33 percent in order to maintain the present reserve target of 3 percent a year. Such a move had to be ruled out. It would be inappropriate at present for the Fund to increase its rate of charge and to place additional burdens on debtor countries.

The objective of increasing the rate of remuneration should be pursued flexibly, along the lines suggested by Mr. de Maulde, Mr. Coene considered, i.e., by using the opportunities created by a drop in market interest rates to increase the rate of remuneration relative to the SDR interest rate without increasing the rate of charge. If the Executive Board were willing to work within a reasonable time frame, not longer than four to five years, such an objective should be easily attainable. The Fund had few other means of accommodating an increase in the rate of remuneration without increasing the rate of charge. The reserve target for net income was small and did not permit much room for maneuver. A change in that target would, moreover, adversely affect perceptions of the Fund's financial strength. Nor should past reserve increases be used to keep the rate of charge lower.

Mr. Tshishimbi commented that he shared the concerns of some other Directors about the one-sided presentation in EBS/83/237. The staff had analyzed the evolution of the rate of remuneration and the SDR rate, as well as the relationship between the two rates. The analysis showed the rates to have been equal until the end of 1978. In January 1979, however, the rate of remuneration had been set at 72 percent of the combined market rate and the SDR interest rate at 80 percent of that combined rate. A year and a half later, the two rates had been raised to 85 percent and to 100 percent of the combined market rate, respectively. The disconnection between the two rates introduced in 1979 and maintained on the occasion of the last change in the rates had clearly been a signal by the Executive Board that it was reluctant to endorse full indexation of the rate of remuneration to the rising combined market rate. Wishing to promote the role of the SDR as the major asset in the international monetary and financial system, the Executive Board had agreed to increase the SDR rate to a higher level than the rate of remuneration, but the Board had recognized at the same time the possible negative impact that raising the rate of remuneration could have on the Fund's income position and on the rate of charge. In that regard, the Board had taken a cautious approach.

In EBS/83/237, the staff appeared to recommend clearly that the rate of remuneration should be raised again substantially, to 100 percent of the combined market rate, i.e., the rate already set for the SDR, Mr. Tshishimbi continued. The argument behind such a recommendation was that, if the rate were set at the proposed level, a reserve tranche position in the Fund would become as attractive an asset as the other financial assets available to creditor countries. There was logic behind the argument that the rate of return on the reserve tranche should be raised in order to encourage the expansion of reserve tranche positions at a time when Fund credit was expanding. However, there was no assurance that raising the rate of return would produce the stated objective.

The staff itself had suggested that there was more than one feature that could make reserve tranche positions more attractive, Mr. Tshishimbi observed, such as their encashability, their transferability, and their maturity. The staff also suggested that the mechanisms by which reserve tranche positions were created, increased, or decreased, as well as the applicability of the rate to all or part of the reserve tranche positions, constituted other important factors. A more balanced approach, based on all those criteria, would have been more useful for the Executive Board's examination of how to improve the creation or expansion of Fund credit. A mechanistic increase in the rate of remuneration would not provide a solution, particularly because it would bring about an increase in the rate of charge. Unless market rates of interest declined, an increase in the rate of charge would become necessary in order to achieve a given income target set by the Executive Board. There seemed to be too much emphasis on the role that the rate of remuneration played in Fund credit.

His chair was not convinced that there was a case for an increase in the rate of remuneration at present, Mr. Tshishimbi stated. The Executive Board should bear in mind that the Fund had a unique role to play in the international financial system. That role involved the provision of financial assistance to all members in need of help to solve their balance of payments difficulties. Such assistance should maintain its revolving character, but it should also be concessional. Some Directors' remarks appeared to suggest that Fund credit should be reduced to as small an amount as possible and that it should be provided on the most onerous terms. Those remarks constituted a serious dimunition of the cooperative character of the Fund.

Mr. Prowse remarked that the views of the authorities in his constituency differed markedly on the question before Executive Directors; some of his authorities would be prepared to accept an increase to 100 percent in the rate of remuneration, while others preferred that there should be no increase. However, all of his authorities agreed that the Fund was a cooperative institution and that all members, whether creditors or debtors at any given time, benefited from the role of the Fund in the international financial system. Therefore, their highest objective was to maintain a strong and effective Fund. They hoped that a compromise could be reached on the question under discussion.

Leaving aside the many technical issues involved, Mr. Prowse observed, an increase in the rate of remuneration at present to 100 percent of the SDR rate would have a relatively rapid effect on the rate of charge. As a result, borrowers would be paying the cost of higher remuneration. Furthermore, the Fund would be transferring several hundred million SDRs to those holding remunerated positions. In light of the considerable attention being focused on the international debt problem, it would not be appropriate to raise charges substantially at present.

In EBS/83/237, the staff had clearly set out the various issues, properly leaving the final judgment to Executive Directors, Mr. Prowse continued. Reserve tranche positions subject to remuneration were currently the only creditor claims on the Fund with a yield below a market-related rate of interest. An increase in the rate of return on the reserve tranche positions was consistent with the objective, which his authorities supported, that the Fund should rely primarily on quotas rather than on borrowed resources. A further argument in favor of some increase in the rate of remuneration at present was the prospect that interest rates were not likely to fall much more in the near future. If an increase in the rate were postponed, and if it were made following a further rise in interest rates, the increase might have to be very large. However, it was also true that concessionality was important and that the rate of remuneration had been a major element in concessionality. The free balances, which had been another important element in concessionality, were declining with every quota increase.

If there were a consensus within the Board in favor of an increase in the rate of remuneration, Mr. Prowse went on, he could support one, beginning in May 1984, to 92.5 percent of the SDR rate. However, the impact of such an increase on the rate of charge had to be taken into account. Therefore, he could support the phased approach suggested in paragraph (iii) on page 14 of EBS/83/237 as well as measures to improve the Fund's income on some of its assets as suggested in paragraph (iv) on the same page.

Mr. Robalino said that he was aware of the problems that could be created by having a rate of remuneration lower than the SDR rate. However, he was also conscious of the financial problems being faced by the debtor nations of the developing world. If the Executive Board increased the rate of remuneration, it would soon decide to increase the rate of charge in order to avoid running into problems with regard to the Fund's income position. An increase in the rate of charge to the debtor nations would add to the financial problems of the developing world. On those grounds, it would not be prudent to increase the rate of remuneration at present.

Mr. Nimatallah commented that the staff had provided a balanced assessment of the arguments for and against raising the rate of remuneration, but it had concluded by making a case in principle for raising the rate closer to the SDR rate. He could accept such a proposal, provided that the rate was not raised abruptly and in one stage. The increase should be stretched gradually over a reasonable period of time; it should be implemented in stages with a view to safeguarding the Fund's income position and mitigating the impact on charges. He had an open mind on the appropriate length of time, but it should not be less than 18 months.

If the rate of remuneration was to be raised, Mr. Nimatallah continued, it was essential that the Executive Board should explore all possible ways of reducing the impact on charges. Three parties were involved: borrowing members, creditor members, and the Fund itself. All three should cooperate to find an equitable way of spreading the burden of a higher rate of remuneration. His support for the proposed increase in remuneration was based on the assumption that the Executive Board's decision on remuneration would be taken together with the decisions to extend the enlarged access policy and to set new access limits under the special facilities. He expected that a decision to raise the rate of remuneration would be accompanied by a decision extending the enlarged access policy for 1984 and by a decision on the special facilities that would provide for access under the compensatory financing facility at not less than 85 percent of quota and that would retain the present 50 percent limit for access to the lower segment of the facility.

Mr. Finaish said that the staff's analysis clearly showed that the issue before Directors necessarily involved trade-offs. A close relationship existed among the rate of remuneration, the rate of charge, and increases in the Fund's reserves. Arguments could be found for increasing the rate of remuneration, for accelerating the growth of reserves, and for maintaining or increasing the concessionality of the Fund's assistance. However, those objectives could not be simultaneously attained; therefore, a careful balance had to be struck. Because no change had been proposed in the target growth of the Fund's reserves, an adjustment in the rate of remuneration and the timing of that adjustment had to be balanced against the effect on the rate of charge.

An attempt should be made to reduce to the extent possible the adverse effect on the cost to member countries of Fund assistance, Mr. Finaish continued. For that reason, an immediate increase in the rate of remuneration to 100 percent of the SDR interest rate, accompanied by an abrupt increase in the rate of charge that would substantially reduce the concessionality of Fund assistance, was inadvisable, particularly in view of the staff's assessment of the positive effect of relatively high concessionality since 1980 on the process of adjustment. Moreover, a large increase in the rate of charge could adversely affect the ability of borrowing countries to fulfill their debt obligations. A gradual adjustment in the rate of remuneration, therefore, would be more balanced and more prudent. It would not require a sharp increase in the rate of charge; consequently, it would help to smooth out the adverse impact on borrowing countries. The gradual approach would also reduce the chances of the Board's having to reverse the direction of adjustment in the rate of remuneration because of unforeseen developments in the international economy during the current period of great uncertainty.

It had been suggested that the impact on charges could be moderated by using the surplus accumulated in 1982 and 1983 to meet future reserve growth targets, Mr. Finaish noted. Additional steps mentioned by the staff could also be taken, including the possibility of increasing the Fund's income from investment of some of its assets. Such considerations suggested that an appropriately gradual approach could be followed in adjusting the rate of remuneration. For example, the initial increase could be made at a time when it need not be large. The timetable for further increases should be flexible to allow for unforeseen developments in the relevant variables. Given the differences in the preferences expressed by Executive Directors, and, indeed, the diversity of views within his own constituency, as well as the fact that the debtor countries would be immediately and adversely affected by any increase in the rate of remuneration that resulted in an increase in the rate of charge, it would be difficult to reach a decision based on voting power. It would be much more desirable to reach a consensus acceptable to the Executive Board as a whole. He could, therefore, support a reasonable compromise if it gained the support of a broad consensus within the Board.

The Treasurer observed that a number of Directors had commented on the staff's presentation in EBS/83/237, suggesting that the paper had given too much weight to the views of creditors. Such comments were disturbing because the staff, aware of the difficulties that the issue raised for the various parties involved, had taken no position on the question before Executive Directors. The paper had been prepared in response to a request by the Executive Board that the staff should examine whether an increase in the rate of remuneration was timely and what the consequences of such an increase would be for the Fund's financial position. The staff had, therefore, deliberately focused strictly on the impact of an increase on the financial position of members and of the Fund itself.

In Section IV, entitled "Summary and Conclusions," and in greater detail elsewhere in the paper, the Treasurer continued, the staff had outlined both the arguments in favor of an increase in the rate of remuneration and the consequences that an increase would have for charges. The staff had stated clearly that charges would have to rise if the Executive Board agreed to increase the rate of remuneration, unless market interest rates declined. One Executive Director had picked up that point to suggest that an increase in the rate of remuneration should be deferred until market interest rates declined to the point at which the rate of remuneration could be increased to 100 percent of the SDR interest rate without raising charges.

The staff had also discussed the impact of an increase in the rate of remuneration on the concessionality of the Fund's charges, the Treasurer remarked. It had expressed the view that the level of Fund charges should be such as to encourage members to take timely adjustment measures with the Fund's assistance. The point had also been made that for many years reserve tranche positions had not been remunerated, but that the Articles of Agreement had been amended in that regard because there had been a desire to remunerate creditors. The staff had also noted that one factor, although by no means the only factor, contributing to the reluctance to increase quotas was the substantial subsidy involved in the rate of remuneration. There could clearly be two views on the appropriate degree of concessionality, and Directors could find arguments for either set of views in the paper. Ultimately, however, the question could be resolved only by a decision of the Executive Board.

The staff had gone on to point out a number of ways in which the impact of an increase in the rate of remuneration could be mitigated, the Treasurer added, and several Executive Directors had expressed interest in those suggestions. It had also been noted by the staff that the Fund had the authority to raise income in ways other than through charges; however, Executive Directors' comments at the present meeting suggested that they did not generally favor such an approach. In sum, the staff had been aware of all the difficulties involved, and it had attempted to set out the position in as neutral a manner as possible. With that consideration in mind, it had made no recommendations.

The staff representative from the Treasurer's Department recalled that at the previous meeting one Executive Director had inquired about the relationship between the projections of the rate of charge set out in EBS/83/237 and a statement in that staff paper that the present income position of the Fund indicated that there was no need under the rules to change the rate of charge. That statement had been based strictly on the present relationship between the rate of remuneration and the SDR rate and on income and expenditures in FY 1984. The projections in EBS/83/237 had been made in reference to FY 1985 and to the estimated use of Fund resources in that year; they indicated the need to increase charges to meet the income target, depending on the relation of the rate of remuneration to the SDR rate.

Mr. Erb said that a number of Executive Directors had commented on the impact of an increase in the rate of remuneration on the willingness of governments to maintain reserve positions in the Fund, expressing concern that an increase in the rate would not necessarily lead to an increase in such positions. The likely impact was difficult to quantify, but an indication of creditors' preferences could be gained from examining the Fund's recent borrowing efforts. Some of the borrowing arrangements arrived at, which were frequently more liquid from the creditors' standpoint than the reserve tranche position in the Fund, carried a rate of interest above the SDR rate and were related to a set of market rates that would generally be close to those on money market instruments. The situation suggested that the interest rate was an important factor in shaping the willingness of countries to maintain a reserve position within the Fund. More generally, the existence of a highly subsidized rate of charge made it more difficult to support a streamlining of the Fund's borrowing arrangements with official institutions. If there turned out to be a wide spread between the rate that the Fund paid on borrowing and the rate of charge, a problem of arbitraging could arise, especially if countries simultaneously borrowed from the Fund at a much lower rate than the one at which they were lending to it. Raising the rate of charge closer to the rate of remuneration would reduce the magnitude of that potential problem.

It had been suggested that the Executive Board should focus more closely on the need for a further increase in quotas, Mr. Erb went on. The rate of remuneration and the rate of charge had been issues affecting the willingness of some members of the U.S. Congress to support the recent increase in quotas, and a firm commitment by his authorities to make an effort to raise the remuneration rate to a market-related rate had been helpful in obtaining the necessary support for the quota increase. If the rate were increased to an appropriate level at an earlier date and not limited to the completion of the next quota review, the U.S. authorities would be more willing to discuss the timing of the Ninth General Review of Quotas. The cost to the United States of Fund programs would be an important factor influencing their decision in that regard.

The degree of concessionality in Fund charges and the cooperative character of the Fund were important, but not necessarily related, issues, Mr. Erb commented. The cooperative character of the Fund was evidenced when countries in a strong balance of payments position provided assistance through the Fund to countries in a weak position. It was also evident in the revolving nature of such assistance. However, the process of cooperation did not imply that the resources had to be provided at a highly concessional rate. In practice, when members in a strong position used their creditworthiness to borrow in their capital markets at prevailing market rates of interest in order to support the Fund, they were effectively providing resources at a concessional rate to the members in a weak balance of payments position. Furthermore, if an increase in the rate of remuneration to the full SDR rate led to an increase in the rate of charge to 8.33 percent, the latter rate would still contain a substantial element of concessionality.

The proposition that there had to be a high degree of concessionality in order to persuade countries to come to the Fund early or to accept Fund conditionality was difficult to accept, Mr. Erb considered, because it encouraged the perception that Fund conditionality was detrimental to a country and that, therefore, the Fund had to charge a relatively low rate of interest in order to induce countries to adopt policies that they ought to be adopting in their own economic interest. When the Fund provided resources, it eased the adjustment problem facing the country; it did not have to go a step further and provide those resources at a highly subsidized rate. Indeed, if a country came to the Fund simply because the resources provided were subsidized, it raised questions about the degree of commitment to the policies that the authorities agreed to adopt. It would be possible to find examples of situations in which the country's economic policies had deteriorated as soon as Fund lending had ceased, suggesting that the country had not been sufficiently committed to the required policies or that it had not perceived those policies to be in its own self-interest.

Given the financial pressures faced by many debtor countries at present, Mr. Erb remarked, the Executive Board had to ensure that an increase in the rate of remuneration did not have a dramatic impact on charges. For that reason, he supported a phasing-in of the increase during 1984. Concern over the debt problem had led some Directors to suggest that there might be a conflict between raising charges and the need for the Fund to speak out against excessively high spreads and fees charged by commercial banks. His authorities agreed that it was wrong for commercial institutions to raise their spreads and fees excessively in circumstances in which public resources were being used to assist in the solution of external financial problems, but such a view was consistent with the view that highly subsidized interest rates were undesirable. Not only did highly subsidized rates of interest raise general questions about the efficient allocation of resources, but they could also create misconceptions about the Fund's activities. In general, it was undesirable to set interest rates on the basis of political considerations; it was preferable that they should be set by market forces. If the Fund's charges remained highly subsidized, they could lead to pressures for inappropriately large-scale and long-term lending. For example, countries in a position to make voluntary early repurchases as their balance of payments position improved might be less likely to do so. There had been cases in recent years in which it could be argued that some countries had used subsidized Fund resources rather than making full use of available commercial borrowing opportunities.

Finally, the link between remuneration and charges and other aspects of the Fund's financial position, such as its lending policies, had to be considered, Mr. Erb suggested. There had been agreement in the Interim Committee that the Fund's lending policies had to be in line with its resource base. Clearly, the terms on which the Fund obtained resources, as well as those on which it lent resources, affected its financial position. For that reason, his authorities favored setting both the rate of remuneration and the rate of charge at a level that reflected market-related rates of interest.

The Chairman commented that Executive Directors had argued along divergent, but not necessarily irreconcilable, lines. Those Directors who had favored setting the rate of remuneration at 100 percent of the SDR rate had suggested, inter alia, that there was no logical basis for the difference in the treatment of reserve tranche positions in the Fund relative to other claims on the Fund. They had noted, with profound concern, that the reserve tranche positions were the only claims on the Fund not remunerated at market-related levels, although such positions were not the most liquid and usable assets held by Fund creditors. It should also be noted that the concerns expressed by Executive Directors in that regard were not new; they had been gaining momentum over a number of years, as evidenced by the Fund's dealings with creditor countries in the context of borrowing arrangements. The Executive Directors on that side of the argument also considered that a market-oriented rate of remuneration was consistent with the cooperative character of the Fund. They had noted the revolving nature of the Fund as an institution that lent to countries at some times while borrowing from the same countries at other times. The costs and benefits of membership in the institution were thereby spread among all members. They had also suggested that, even if the rate of remuneration were raised immediately to 100 percent of the SDR rate, there would continue to be, in their view, a substantial concessional element in Fund charges.

Another group of Directors, strongly emphasizing the cooperative nature of the Fund, had argued that the concessionality of the Fund's assistance should be reflected, at least in part, in the rate of remuneration. For those Directors, that argument was an important point of principle. They had also indicated that an immediate increase in the rate of charge stemming from an increase in the rate of remuneration to 100 percent of the SDR rate would be particularly undesirable because it would reduce sharply the concessionality of the assistance provided by the Fund at a time when interest rates remained high in real terms and when, they considered, the hardships faced by the debtor countries did not warrant a further increase in charges on the part of the Fund. Those Directors had also suggested that too abrupt an increase in the rate of charge could induce countries to refrain from using the resources provided on conditional terms by the Fund or could discourage the use of Fund resources at an appropriately early stage in the emergence of balance of payments problems. Some of those Directors had also expressed concern that the borrowing countries would inevitably bear the cost of future increases in the Fund's administrative expenses and reserves.

It was not unusual for Executive Directors to express different points of view on such an issue, the Chairman remarked. One group of Directors was concerned about the anomaly of the rate of remuneration being set at a lower level than other remunerated positions in the Fund. The other group was concerned about the impact of an increase in the rate of remuneration above the rate of charge, an important aspect of members' financial dealings in the present difficult times. Both sets of concerns were valid. The issue could be resolved only through compromise. He did not believe that it would be possible to resolve it either through immediately increasing the rate of remuneration to 100 percent of the SDR rate or through simply ignoring the problem and allowing the 85 percent level to continue. A compromise could include agreement to move toward a market-based rate of remuneration in a gradual, but progressive, manner. It appeared that a solution broadly along the lines that he had indicated would be acceptable to a majority of the Executive Board. However, it was clear that further discussion was necessary, not only on the rate of remuneration, but also on related issues affecting the Fund's income position and reserves. He hoped that such issues could be discussed at an early date in order to reach a decision acceptable to all Directors.

Mr. Malhotra observed that approximately SDR 1.9 billion of the Fund's quota-related resources was not remunerated at present. At the same time, the Fund's administrative expenditures, which were increasing rapidly, amounted to about SDR 200 million. If the rate of remuneration were increased to 100 percent of the SDR rate, the cost of future increases in administrative expenditures and reserves would be borne by the borrowing countries, rather than through the unremunerated positions of creditors. It was questionable whether such a prospect was compatible with the cooperative nature of the Fund. The suggestion that a schedule should be set to enable the rate of remuneration to reach 100 percent of the SDR rate by a specified date was a new interpretation of the Articles of Agreement. It had previously been understood that the cost of administrative expenses and reserves should be borne by all members and that the normal mechanism for doing so was through contributions to the reserve tranches. Those points deserved emphasis.

The Treasurer said that, under the Articles of Agreement, the responsibility for financing the administrative expenses of the Fund was shared by the membership at large. There was no mechanism that placed the responsibility for administrative costs on a particular group of members. When there was a surplus in the Fund's income position, it was commonly shared by the members either through an addition to reserves or through a distribution of net income. When there was a deficit, it was also commonly shared, either through a reduction in reserves or through a reduction in the rate of remuneration to the maximum extent feasible, in order to keep it as low as possible in relation to the SDR rate.

The interest rate policy applied by the Fund in relation to both debtors and creditors was, in principle, a separate issue from the result that the policy had on the Fund's income position, the Treasurer added. As an extreme example, it would be possible for the Executive Board to decide to pay a high rate of interest on the SDR in order to promote the asset in the international monetary system, while setting the rate of remuneration at 100 percent of the SDR rate, and imposing very low charges. In such circumstances, the Fund's income position would be sharply in deficit. Such a deficit would be financed through reducing the reserves to zero, or, if that action proved insufficient, it would be shared by the member countries in proportion to their share of quotas in the event of the liquidation of the Fund. Thus, ultimately, the Fund's income position was protected through the Executive Board's willingness to support it by setting a reserve target.

He did not wish to advocate a change in that policy, the Treasurer went on. In principle, the responsibility for the Fund's administrative expenses could be shared by the membership as a whole in a number of ways. The Articles of Agreement did not distinguish between the cost to the Fund of recompensing creditors through remuneration of reserve tranche positions and the cost of paying interest to lenders. The distinction was a technical accounting device aimed at presenting as clearly as possible the cost of operation and the cost of administration. While it was true that administrative expenses had been rising rapidly, there was reason to believe that they would not continue to grow at the same rates in years ahead, assuming, of course, that inflation did not accelerate. A number of one-time expenditures had been involved recently, such as the cost of the new building, which had been written off at a relatively rapid rate, and the cost of improvements in the Fund's data processing capabilities.

The Articles of Agreement permitted the Executive Board to raise the norm for remuneration to 100 percent of quota, the Treasurer noted, and they did not prescribe limits to the circumstances under which the Board could take such action. If such action was taken, the resources that Mr. Malhotra had referred to as "interest free" would become subject to remuneration. Furthermore, there was no provision in the Articles of Agreement that the rate of remuneration should be less than 100 percent of the SDR rate in those circumstances. That issue was subject to a decision by the Executive Board, based on consideration not only of the Fund's income position but of the kinds of concerns raised by Executive Directors at the present meeting. Of course, as the staff had pointed out in EBS/83/237, it was possible for the Fund to obtain income through means other than charges, such as through investment of resources up to the equivalent of reserves.

The Director of the Legal Department stated that the Articles of Agreement clearly permitted the raising of the rate of remuneration to 100 percent of the SDR rate. In taking such action, the Fund had to take into account the periodic rates of charge. However, no particular fixed relationship between the two rates had to be observed. The Articles did not prescribe mechanisms for sharing the burden of expenses among various groups of members.

Mr. Malhotra said that his point was that unremunerated assets were not an element in concessionality, as had been argued in the staff paper. The requirement that administrative expenses and reserves were to be shared by all members had to be taken into account. While it was true that there were means of increasing the Fund's income other than raising the rate of charge, little consideration had been given to them. If the rate of remuneration were raised to a point at which charges would have to be raised so that borrowers alone bore the burden of future increases in administrative expenses and reserves, thereby eliminating concessionality, the cooperative character of the Fund would be impaired. The Board should not adopt the target of 100 percent of the SDR rate for the rate of remuneration, because to do so would mean that the burden of future expenses would fall, in practice, on the borrowing countries alone.

The advisability of joining a number of separate issues together in a "package" was open to serious question, Mr. Malhotra considered. For example, the decision on the enlarged access policy would require an 85 percent majority, while a decision on the rate of remuneration would require a 70 percent majority, and a decision on access under the special facilities required a 50 percent majority. While it might be desirable to develop a consensus that all Executive Directors could live with, it was not desirable to proceed in an ad hoc way to link issues that required different majorities. In those circumstances, there was a danger that the interests of the weaker members would suffer.

The Director of the Legal Department noted that, with regard to the special facilities, a decision to maintain the floating character of the cereal facility required an 85 percent majority.

Mr. Malhotra commented that decisions to change access under the special facilities and to maintain the floating character of the floating cereal facility were separate decisions. The former decision required only a simple majority.

Mr. de Maulde said that he agreed with Mr. Malhotra that it was important to maintain the cooperative character of the Fund. However, even in cooperative financial institutions, administrative expenses were financed through interest charges. The difference between a cooperative bank and a commercial bank was that the former did not make an excess profit.

The Chairman observed that the SDR 1.9 billion of interest-free resources produced approximately SDR 160 million in income for the Fund. Insofar as the creditor countries had the largest share in quotas, they bore the major part of the burden of the administrative expenses through their share in interest-free resources. It was in that light that the question whether future increases in administrative expenses should be borne by the debtor countries alone through charges should be viewed.

The Treasurer commented that the category of "interest-free resources" included unremunerated reserve tranche positions of about SDR 1.9 billion, the Fund's reserves of about SDR 1 billion, and income from the sale of gold of about SDR 1.9 billion. With regard to reserves, it could be said that debtors had helped to create reserves if the payment of charges had resulted in a surplus in the Fund's income in a given year, but it could also be argued that creditors had made a contribution in surplus years through acceptance of a rate of remuneration below 100 percent. Taking reserves and unremunerated positions together, the income produced would be higher than SDR 160 million.

Mr. Malhotra remarked that he agreed that reserves were created through the contributions of all members. He also agreed that the creditors, who held a major share of quotas, made a significant contribution through the unremunerated reserve tranche positions. However, if those positions became a progressively smaller percentage of the Fund's income in future, the burden of administrative expenses would increasingly fall on the debtor countries. That fundamental issue should not be ignored.

The Treasurer said that he agreed with Mr. Malhotra that, if quotas should be increased in the future, the ratio of unremunerated reserve tranche positions to quotas would decline. Furthermore, on the assumption that the Fund extended credit in proportion to the increase in quotas, the interest-free resource base represented by unremunerated reserve tranche positions would also decline as a proportion of the Fund's lending. Indeed, that development had already been taking place. Thus, when the Fund extended a large amount of credit, as it was doing at present, relative to the unremunerated positions, a lower rate of remuneration had a larger bearing on the creditors' income positions arising from their reserves in the Fund. In that sense, the element of concessionality was relatively higher. Those facts could be used to support either side of the present argument.

The Executive Directors agreed to resume their discussion in the afternoon.

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/83/175 (12/16/83) and EBM/83/176 (12/19/83).

2. PUBLICATION OF "INTEREST RATES AND TAX TREATMENT OF INTEREST INCOME AND EXPENSES" AND BACKGROUND PAPERS

The Executive Board approves the proposal set forth in EBD/83/313 (12/6/83).

Adopted December 16, 1983

APPROVED: April 17, 1984

LEO VAN HOUTVEN
Secretary