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SM/01/78

March 5, 2001

To: Members of the Executive Board

From: The Secretary

Subject: **Financing the Fund's Operations—Review of Issues**

Attached for the information of the Executive Directors is a paper intended to serve as a reference on the Fund's finances conducted through its General Department. The paper describes how the Fund obtains its capital resources, its main financial operations, and the key elements underlying its costs and revenues. It concentrates on reviewing past and recent efforts to simplify or modify the Fund's finances.

It is proposed that this paper be published, after editing and taking into account any comments received from Executive Directors by Friday, March 30, 2001.

Questions may be referred to Mr. Roncesvalles (ext. 37800).

Att: (1)

Other Distribution:
Department Heads

INTERNATIONAL MONETARY FUND

Financing the Fund's Operations—Review of Issues

Prepared by the Treasurer's Department

(In consultation with the Legal Department)

Approved by Eduard Brau

March 2, 2001

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I. INTRODUCTION

1. **This paper serves as a reference for discussion of the Fund's finances conducted through its General Department.** It describes how the Fund obtains its capital resources, its main financial operations, and the key elements underlying its costs and revenues. The paper also reviews past and recent efforts to simplify or modify the Fund's finances.

2. **The paper is organized as follows.** Section II describes the financial structure of the Fund, comparing this structure with that of other financial institutions, and discusses how the burden of paying for the Fund's operating cost is borne by its members. Section III deals with the issues raised by proposals to modify the structure and operation of the Fund's finances. Among these issues are the extent or degree of concessionality in the Fund's lending, the incentives for members to repay the Fund, "equity" in the incidence of the cost of operating the Fund, and the difficulties encountered annually when the Fund determines the level of the interest rate on its lending. Section III also discusses efforts to simplify the Fund's finances or make them more transparent. A final section gives some concluding remarks.

II. THE STRUCTURE AND OPERATION OF THE FUND'S FINANCES

A. Financial Structure and Balance Sheet

3. **In its financial dimension, the Fund is a cooperative of (currently) 183 countries, lending reserve assets (foreign exchange) to some of its member countries from resources subscribed by all members.** The Fund's lending furthers one of its purposes set out in its *Articles of Agreement* (hereafter, the *Articles*): to give borrowing members confidence and the opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity (Article I (v)).

4. **The Fund is mainly a pool of currencies and reserve assets built up from members' fully paid capital subscriptions in the form of quotas.**¹ A quarter of a member's quota subscription payment is normally paid in reserve assets, in gold prior to the second amendment of the *Articles* in 1978, and since then, in SDRs or "usable" currencies of other members as determined by the Fund.² The balance of the member's subscription is paid in its own currency. Consequently, a portion of the Fund's pool consists of unusable currencies,

¹ A member's quota and subsequent increases in quota are agreed with other members. Quotas themselves are reviewed, and possibly increased, every five years, and as of end-2000, total quotas amounted to SDR 211 billion (about \$275 billion). For how quotas are determined, see Chapter III of "External Review of the Quota Formulas," EBAP/00/52 (5/1/00).

² A currency is usable if the issuing member's external payments position is strong enough for it to be called upon to finance other members' use of Fund resources. Other currencies are considered unusable. A quota payment made by a member using another member's currency requires concurrence by the latter.

i.e., the currencies of borrowers or financially weak members, leaving the Fund's lending capacity at about two thirds of total quotas.³

5. **Members acquire a liquid claim on the Fund in exchange for reserve assets they provide.** This claim, called the "reserve tranche position," is by definition equal to the member's quota minus the Fund's holdings of the member's currency. Thus, the reserve asset paid by a member for its quota subscription creates an equal amount of reserve tranche position, and creditor members' reserve tranche positions rise (fall) as the Fund lends to other members (when borrowing members make repayments), as indicated in Box 1. Reserve tranche positions are part of members' liquid international reserves because a member may, subject only to its representation of balance of payments need, convert its reserve tranche position into reserve assets by drawing on the Fund. The distribution of reserve tranche positions among the members is subject to operational guidelines on the execution of the Fund's financial transactions (Box 2).

6. **Members borrow from the Fund using their credit tranches, or under special policies or facilities** (Box 3).⁴ The credit tranches, usually accessed through stand-by arrangements, provide credit for any balance of payments need, whereas credits under other facilities (the Extended Fund Facility (EFF), the Supplemental Reserve Facility (SRF), Contingent Credit Lines (CCL), the Compensatory Financing Facility (CFF), and emergency assistance) deal with specialized needs.⁵ The Executive Board undertook a major review of the Fund's financing facilities in 2000, and as a result, it eliminated a number of little used facilities, enhanced the terms and conditions of the CCL, and introduced or strengthened the mechanisms that ensure that countries do not rely on Fund credit for excessively long periods or in excessively large amounts.⁶

7. **The Fund's pool of resources can also be increased through additions to its precautionary balances.** These balances comprise the Fund's reserves as well as resources that have been set aside in the special contingent accounts (SCAs). These resources are not

³ A member with unusable currency provides the Fund with usable resources only through the reserve asset portion of its quota subscription, whereas all of the quota payment by a country with a usable currency represents usable resources. The currencies paid in by members are held by the Fund in depository accounts at members' central banks.

⁴ Fund credit is normally governed by its general lending policies (also known as "credit tranche" policies), as opposed to the special policies that apply to other Fund credits. For historical background, see "Review of Fund Facilities—Preliminary Considerations," EBS/00/37 (3/2/00).

⁵ Although noted in passing, the Fund's lending to low-income countries under its concessional facility, the Poverty Reduction and Growth Facility (PRGF), is not covered in this paper. The Fund also provides support to heavily indebted poor countries through the PRGF-HIPC Trust.

⁶ See the Summing Up of the Board's concluding discussions (BUFF/00/175 (11/27/00) and PIN No. 00/101, 11/30/00. See also "Review of Fund Facilities—Further Considerations," EBS/00/131 (7/10/00); "Review of Fund Facilities—Follow Up," EBS/00/187 (8/31/00); and "Review of Fund Facilities—Proposed Decisions and Implementation Guidelines," EBS/00/216 (11/3/00), and Supp. 1 (11/21/00).

Box 1. The Fund's Lending Mechanism

Members draw on the Fund's pool of resources through a purchase-repurchase mechanism. A member using its reserve tranche position or obtaining credit from the Fund "purchases" from the Fund either SDRs or the currency of another member in exchange for the purchasing member's currency, and repayment of the credit is effected by a "repurchase," a reversal of the original transaction.¹ By design of the Fund's financing mechanism, the currency purchased must be that of a creditor country, i.e., one with a strong external position, whose subscribed currency is considered usable for Fund transactions.

A member's purchase of currency reduces the Fund's holdings of the currency purchased, enlarges the reserve tranche position of the country whose currency is purchased, and increases the Fund's holdings of the purchasing member's currency. Consequently, members' purchases and repurchases change the composition but not the value of the Fund's pool of resources. In planning and executing members' transactions, the Fund uses currencies in a manner that adjusts creditor members' reserve tranche positions toward a uniform proportion of their quotas. In other words, creditor members participate in the financing of Fund credit according to their relative quota shares.

The usability (liquidity) of the Fund's pool of currencies is ensured by established conversion procedures. All members are obliged to ensure that their currencies (held by the Fund and potentially transferable to a borrowing country in a Fund purchase) are either balances of a freely usable currency or can be converted into such a currency.² These arrangements help to meet a drawing member's preference for currency it wishes to purchase.

¹ This financing mechanism has its roots in the credit facilities that existed between central banks before the Fund was established.

² A freely usable currency is one that the Fund determines is widely used to make payments for international transactions and traded in the principal exchange markets. At present, the freely usable currencies are the U.S. dollar, euro, Japanese yen, and pound sterling. See *Proposed Second Amendment to the Articles of Agreement of the International Monetary Fund: a Report by the Executive Directors to the Board of Governors*, Washington, D.C., 1976, pp. 23-25, and Joseph Gold, "Use, Conversion, and Exchange of Currency Under the Second Amendment of the Fund's Articles," Pamphlet Series No. 23 (Washington: IMF, 1978), esp. p. 2, and pp. 68-83.

Box 2. Fund Liquidity and Financial Transactions Plan

1. The Fund's liquidity consists of its usable assets, i.e., its holdings of SDRs and usable currencies.
2. Usable currencies are those of members selected for inclusion in the Fund's quarterly financial transactions plan (formerly called the operational budget). Such members, also called creditor members, are those whose external positions are considered sufficiently strong on the basis of traditional indicators (balance of payments and reserve positions, capital market access, and exchange market developments), supplemented by indicators of short-term external debt and debt service.¹
3. The *extent* of use or allocation of currencies in the financial transactions plan is guided by the objective of equalizing members' reserve tranche positions (i.e., their creditor positions in the Fund) in relation to their quotas. Minor differences from equality in such ratios result when a member first participates in the plan or resumes participation after a period of exclusion.
4. The guidelines on allocation of currencies in the transactions plan were last revised in November 1998.² Prior to this revision, the allocation relied heavily on using members' gross foreign exchange reserves as a distribution key, rather than on quotas. The use of reserves was criticized as not being aligned with the standard measure of members' rights and obligations in the Fund (quotas). Reserves varied widely in relation to quotas because of members' different exchange regimes or access to capital markets. Furthermore, data on reserves presented problems of comparability and usability across countries, including for those using the euro as a common currency.

¹ "Assessment of Members' External Strength for Inclusion in the Operational Budget—Role of Supplementary Indicators," EBS/97/183 (9/24/97).

² "Operational Budget—Review of Guidelines for Allocation of Currencies," EBS/98/194 (11/17/98). The guidelines were reviewed and maintained in November 2000.

Box 3. The Fund's GRA Lending

The Fund's lending made available from the General Resources Account (GRA) is subject to terms that reflect the nature of the balance of payments problem of the borrowing member:

Use of the **credit tranches**, usually under a stand-by arrangement (SBA), is designed to deal with any temporary balance of payments problem.¹ Use of the credit tranches must be repaid within 3¼–5 years. A member is expected to repay within 2¼–4 years if its external position allows it to repay on these terms.

The **Extended Fund Facility (EFF)**, introduced in 1974, is intended for countries with longer-term balance of payments difficulties, resulting primarily from structural problems. The facility has a repayment period of 4½–10 years, which takes account of the need to implement reforms that can take longer to put in place and have full effect than measures undertaken under a stand-by arrangement. A member is expected to repay within 4½–7 years if its external position allows.

The **Supplemental Reserve Facility (SRF)** was introduced in 1997 to supplement resources made available in the credit tranches and the EFF in order to provide financial assistance for exceptional balance of payments difficulties owing to a large short-term financing need resulting from a sudden and disruptive loss of market confidence, such as occurred in the Mexican and Asian financial crises of 1995 and 1997. Repayments are expected to be made within 1–1½ years but can be extended to 2–2½ years.

Contingent Credit Lines (CCL) were established in 1999 as a means of preventing the spread of an ongoing international financial crisis by enabling members pursuing strong economic policies to obtain pre-approval of IMF financing on a short-term basis. The repayment period for CCL financing is the same as for the SRF.

There are also two little-used facilities, the **Compensatory Financing Facility (CFF)** and the **emergency assistance** for natural disasters or for post-conflict countries. The CFF permits use of Fund credit by members experiencing a temporary decline (rise) in export earnings (cereal imports). The Fund's emergency assistance is normally limited to 25 percent of quota.

The **interest rate** charged on Fund credit reflects a "basic" interest rate plus a surcharge. The basic interest rate reflects the interest rate (rate of remuneration) paid to creditors and includes a margin to finance additions to the Fund's reserves and to pay for its administrative expenses. The surcharge of 100–200 basis points applicable for use in the credit tranches and the EFF at high levels of credit outstanding (i.e., use above 200–300 percent of quota) is set to discourage unduly large use of Fund credit. The surcharge of 300–500 basis points under the SRF (150–350 basis points under the CCL) is designed to encourage early repayment. There is no surcharge for credit under the CFF or for emergency assistance.

¹ A stand-by arrangement is a decision of the Fund that assures a member that it can make purchases for specific amounts during a specified period of time, provided the member observes the terms set out in the arrangement. A member with little or no outstanding use of Fund credit may also use its first credit tranche (25 percent of quota) in the form of an outright purchase.

segregated from other resources of the Fund and can therefore finance the extension of Fund credit.⁷

- **Reserves** represent mainly net income of the Fund retained over the years, including from investments. Reserves are intended to meet losses of a capital character or administrative deficits (negative net income), and are categorized as "general" or "special."⁸
- Resources in the SCAs are balances collected from debtor and creditor members through the operation of the burden-sharing mechanism (see paragraph 12 below). Contributions to the SCAs are among the Fund's instruments for dealing with the persistence of overdue financial obligations to the Fund, and resources in the SCAs are refundable to the contributing members.
- The level of the Fund's precautionary balances and their accumulation reflect the Fund's assessment of the risk arising from overdue obligations to the Fund, as well as the residual risk that debtor members in good standing might also fall into arrears (see Appendix I).

8. **The Fund may also borrow.** The Fund has in place the General Arrangements to Borrow (GAB) and the New Arrangements to Borrow (NAB).⁹ These arrangements supplement the Fund's quota resources when needed to forestall or cope with a threat to the stability of the international monetary system. Originally, the Fund could borrow under the GAB only to finance purchases by industrial-country participants in the GAB; in other words, the GAB backstopped the usability of the Fund's quota resources in the event that a participant country needed to draw on the Fund (and its currency became unusable for Fund operations). Presently, both the GAB and the NAB may be used to finance credit to nonparticipant countries.

9. **A part of the Fund's subscribed capital is provided interest-free, and the Fund decides the interest rates it pays creditors and charges debtors.** The interest-free portion, called the unremunerated reserve tranche, is mandated by the *Articles* (see paragraph 13 below). In addition, precautionary balances also represent interest-free resources for the Fund. The Fund determines the levels of the interest rates received by creditors (on

⁷ The Fund may also invest part of its resources in income-generating assets in an amount up to the equivalent of its reserves (see "Gold in the Fund," EBS/95/69 (4/21/95), pp. 7-8).

⁸ The main difference between the two reserves is that the Fund's Executive Board may distribute the general reserve but not the special reserve. Any distribution of the general reserve must be made to all members in proportion to their quotas.

⁹ Under the GAB, which was originally established in 1962, the Fund may borrow up to SDR 18.5 billion from 11 industrial countries or their central banks, and from Saudi Arabia under an associated agreement. Under the NAB, which became operational in 1998, the Fund may borrow up to SDR 34 billion from 25 official lenders. The NAB is the facility of first recourse should the Fund need to borrow, and the limit of SDR 34 billion under the NAB also applies to the combined amounts borrowed under the GAB and NAB.

remunerated reserve tranche positions) and paid by borrowers in a manner that provides creditor members with a competitive return, and generates sufficient interest income to meet the Fund's administrative and operational expenses. These aspects of the Fund's finances are reflected in its balance sheet and income statements (Table 1 and paragraph 11 below). The Fund's decisions on its operational interest rates and its net income are subject to special majorities of total voting power (Appendix II).

10. **The Fund's accounts are formally organized under three separate headings:** the General Department, the Special Drawing Rights Department, and the administered accounts, where the last includes the PRGF and PRGF-HIPC Trusts (Box 4).¹⁰ The General Department contains the General Resources Account (GRA), used for the Fund's main lending operations as well as its borrowing, and the Special Disbursement Account (SDA).¹¹ This paper focuses primarily on the Fund's financial activities undertaken through the GRA.

11. **The Fund's finances are similar to those of other financial institutions,** and comparison between the Fund and such institutions has been made easier by recent changes in the presentation of the Fund's financial statements (see paragraph 40 below). A typical financial institution holds liquid assets and loan claims and securities among its assets, financed by its deposit (monetary) liabilities and capital resources. The Fund holds reserve assets (usable currencies, SDRs, gold) and credit outstanding to its members, and issues monetary liabilities (referred to as reserve tranche positions and discussed in paragraph 5 above), and its capital includes the usable component of quota subscriptions.¹² The Fund uses

¹⁰ The Fund's various accounts are operated, recorded, and accounted for separately. Assets in one department or administered account may not be used to discharge the liabilities or to meet losses incurred in the administration of other accounts or departments, except as permitted by the Articles (see *Proposed Second Amendment to the Articles of Agreement of the International Monetary Fund: a Report by the Executive Directors to the Board of Governors*, Washington, D.C., 1976, pp. 19-20). The use of separate accounts reflects their different purposes and financing sources. For example, the SDR Department reflects the role of the SDR as a supplement to existing reserve assets, and the separation of the SDR system from the Fund's conditional lending (for discussion of how the SDR system operates, see Appendix I of Michael Mussa, James M. Boughton, and Peter Isard, eds., 1996, *The Future of the SDR in Light of Changes in the International Financial System* (Washington: IMF)). The administered accounts are the vehicle for the Fund's concessional lending and grants to low-income countries under the PRGF and PRGF-HIPC Trusts.

¹¹ The SDA is the vehicle for (1) receiving and investing the proceeds from the sale of the Fund's gold in excess of SDR 35 per fine ounce, and (2) use of those resources for special purposes. In addition, the General Department contains an inactive account, the Investment Account, which may hold assets arising from gold profits, a transfer of currencies held in the GRA, or the investment income of the account.

¹² The Fund revised the format of its balance sheet beginning with FY 2000. Previously, the Fund reported all of its pool components as assets in its balance sheet, and liabilities were defined to include quotas plus reserves and other liabilities. In this format, Fund credit and reserve tranche positions were not evident and had to be reported in a supplementary note. For a discussion of the traditional presentation of the Fund's balance sheet and an alternative where the Fund could be depicted as a "bank," see the Appendix in Jacques J. Polak, *Thoughts on an International Monetary Fund Based Fully on the SDR*, Pamphlet No. 28, Washington, D.C., IMF, 1979.

Table 1. The Fund's Balance Sheet and Associated Income and Expense, and Burden Sharing Contributions, FY 2000

(In millions of SDRs)

Balance Sheet (GRA)		Income Statement		Burden Sharing	
	Average Balance	Associated Income (Expense -)			Associated Contributions
1. Assets					
Fund credit outstanding	53,223	+2,548	Charges paid by members 1/	Additional charges, net of refunds 2/	81
SDR holdings	3,379	+123	Interest on SDRs held		
Total assets	56,602	+2,671	Gross operational income		
2. Liabilities and other					
Remunerated reserve tranche positions	50,383	-1,955	Remuneration expense 1/	Reduction of remuneration, net of refunds 2/	81
Interest-free resources 3/	6,219				
Of which:					
Unremunerated reserve tranche positions 4/	2,167				
Precautionary balances 5/	4,052				
Total liabilities and other	56,602	-1,955	Gross operational expense	Total contributions, net of refunds 2/	162
		-448	Administrative expense		
		+268	Net income 6/	Additions to SCA-1 7/	128

1/ Excludes contributions to SCA-1 and contributions for deferred charges under burden sharing.

2/ Including adjustments to make up for total deferred charges of SDR 34 million. Additions to SCA-1 exclude these burden sharing contributions for deferred charges (see footnote 7).

3/ Includes excess of sundry liabilities over sundry assets, which mainly represents differences between net cash receipts and net accruals.

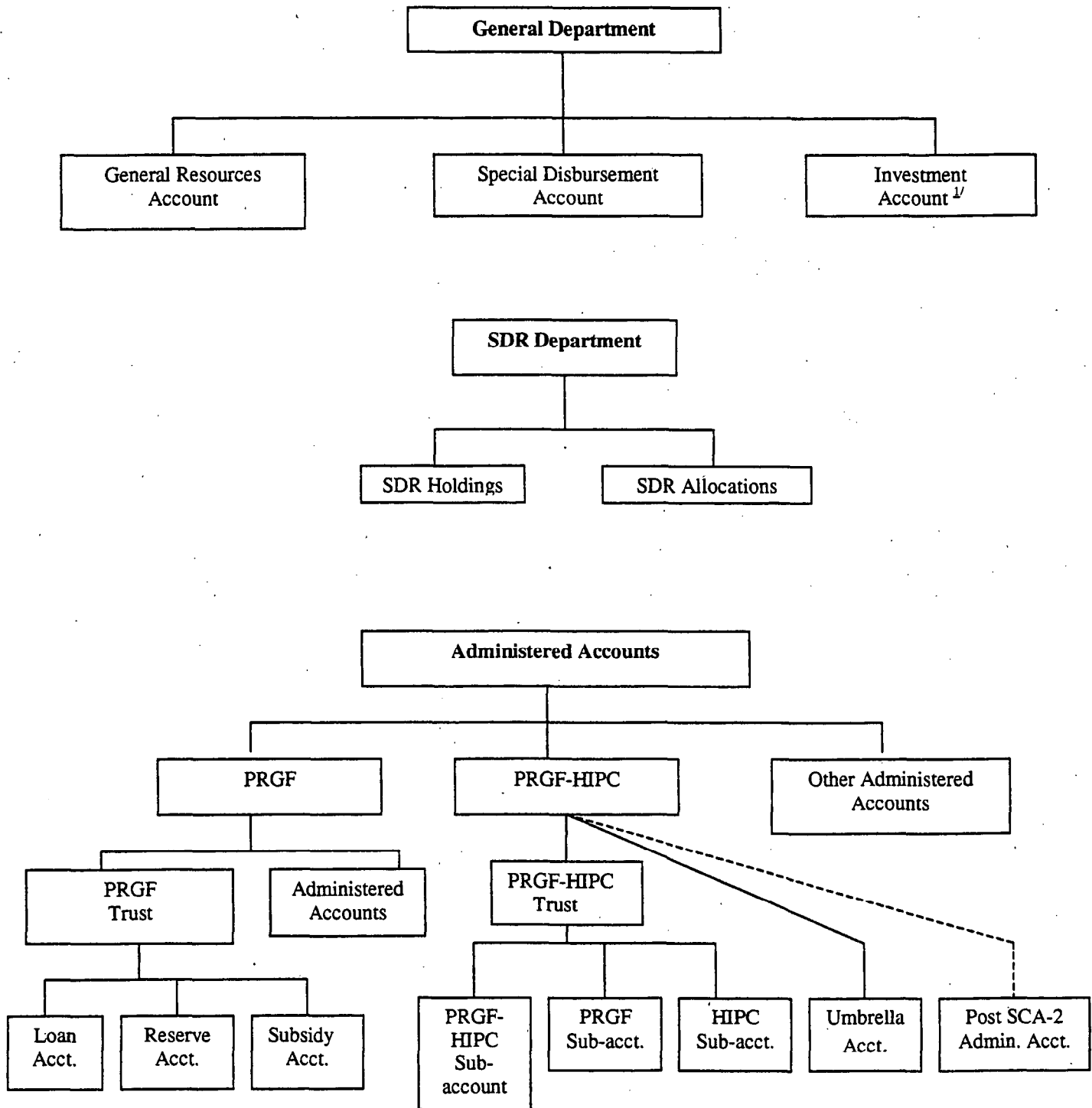
4/ Net of gold holdings.

5/ Reserves and resources contributed by members into SCA-1.

6/ The figure shown for net income excludes the effect of a change in accounting method. In FY 2000, the Fund adopted International Accounting Standard 19 on employee benefits, which resulted in a transitional gain of SDR 268 million.

7/ Burden sharing contributions for deferred charges account for the difference between total contributions under burden sharing and additions to SCA-1.

Box 4. Organization of the Fund's Accounts



^{1/} Account inactive.

and receives SDRs as called for under various provisions of the Articles.¹³ Though held as an asset, gold is not normally used by the Fund in its operations and transactions (Box 5).

B. Costs and Revenues

12. **Interest payments between members and the Fund** are illustrated in Table 1.

- The Fund pays **remuneration** on members' reserve tranche positions at the SDR interest rate, except on a small portion, as indicated earlier. The SDR interest rate, in turn, is determined weekly as a (weighted) average of market interest rates for the currencies in the SDR valuation basket (see Box 6). Consequently, **the Fund's "cost of funds" in the form of the rate of remuneration depends directly on the level of short-term interest rates in the major money markets in the world** (Figure 1). The Fund also pays interest on its borrowings.¹⁴
- The Fund earns income from **charges** on members' outstanding use of Fund credit.¹⁵ **The rate of charge is determined as a proportion of the SDR interest rate that would achieve a target amount of net income** for the incoming financial year. In other words, the rate of charge is set so as to generate revenues that more than cover the Fund's cost of funds.¹⁶ The Fund also receives income from debtor members in the form of service charges, credit commitment fees, and special charges, though the amounts involved are relatively small.¹⁷

¹³ Members tend to use the SDR to make the reserve asset payment for quota increases, raising the Fund's SDR holdings sharply when the five-yearly quota increases take place. The Fund then recirculates SDRs back to members, holding only an amount that facilitates the execution of Fund transactions, some of which, such as interest payments, are normally required to be made in SDRs. See "The Pattern of Use and Holdings of SDRs," EBS/93/104 (6/28/93).

¹⁴ The interest rate on borrowing under the GAB is equal to the SDR interest rate, while that under the NAB may be at or higher than the SDR interest rate.

¹⁵ Income from charges is not based on holdings of members' currencies. The currency portion of the subscribed capital of the Fund, although fully paid up, is held in non-interest-bearing form and generates no income for the Fund until used and converted into claims on members in the form of use of Fund credit. Furthermore, the Fund does not incur currency valuation gains or losses because it denominates its accounts in SDRs, and members are obliged to maintain the SDR value of the currency holdings of the Fund, i.e., a member would have to pay in additional currency to the Fund if its currency were to depreciate against the SDR, and the Fund would refund some of these currency holdings if the currency were to appreciate.

¹⁶ See Rule I-6 (4), reproduced in Appendix III.

¹⁷ The Fund charges a one-time service charge of 0.5 percent on each use of Fund resources in the GRA, other than on reserve tranche purchases which are not subject to the service charge. The Fund also charges a member with a stand-by or extended arrangement a refundable commitment fee, payable at the beginning of each 12-month period of the arrangement, on the amounts that may be drawn over the period, including amounts available under the SRF or CCL (the commitment fee is refunded to the member for drawings it actually makes). Effective on November 28, 2000, the commitment fee was maintained at 0.25 percent on amounts committed up to 100 percent of quota, but reduced to 0.10 percent for amounts committed in excess of

(continued...)

Box 5. Gold in the Fund

1. **The Second Amendment of the Fund's Articles (effective as of April 1, 1978) reduced the role of gold in the international monetary system and limited the Fund's ability to transact in gold.¹**

- The reserve asset portion of quota subscriptions is no longer required to be paid in gold.
- The Fund may sell but not buy gold. In selling, the Fund is required to avoid managing the gold price or establishing a fixed price.
- The proceeds of a gold sale must be distributed as follows: (i) the "capital value" of the gold (i.e., at its acquisition cost of SDR 35 per fine ounce) is placed in the GRA and adds to usable currencies in the Fund's pool of resources; (ii) any excess (the "profits") is held in the SDA and may be used for other purposes permitted by the *Articles*, or invested to earn income.²
- The Fund may accept gold from a member in lieu of SDRs or usable currency when the member settles its financial obligations to the Fund. Such gold must be valued at the market price.
- The Fund may not lease its gold, nor may it use gold as collateral.
- Any gold transaction requires a decision by an 85 percent majority of the total voting power.

2. **The Fund has had a policy of maintaining its gold holdings unchanged since 1980, following sales in 1976-80, profits from which were used to assist the Fund's poorest members. In a further effort to assist such members, the Fund agreed in 1999 to sell gold to some members and simultaneously accept the same amount of gold from them in payment of obligations falling due, and use the investment income from the profits to help fund the PRGF-HIPC Trust.³ The sale/acceptance of gold was made under an understanding that would "ring fence" further gold sales, i.e., that the Fund would not in the foreseeable future engage in similar transactions.**

3. **Gold held by the Fund continuously since the Second Amendment is valued in its accounts at SDR 35 per ounce, its former official price.**

¹ For a comprehensive discussion, see "Gold in the Fund," EBS/95/69 (4/21/95).

² A gold sale reduces the amount of gold potentially available for distribution, in the event of the Fund's liquidation, to the members that were members on August 31, 1975.

³ The Fund holds 103.4 million ounces of gold, including 12.9 million involved in the sale/acceptance. See "Financial and Operational Modalities of Off-Market Transactions in Gold by the Fund," EBS/99/176 (9/15/99).

Box 6. The Fund's Operational Exchange and Interest Rates

The Fund's unit of account

The SDR functions as the Fund's unit of account, whose value is determined daily by a basket of four major currencies – the U.S. dollar, the euro, the Japanese yen, and the pound sterling. The basket approach to SDR valuation has been in effect since 1974. The basket was last revised at the beginning of 2001 to reflect the changing relative importance of the component currencies in the world's trading and financial system. Each member is obliged to maintain the SDR value of the balances of its currency held by the Fund in the GRA, and as a consequence, the total value of such currency holdings is kept constant in terms of the SDR.

SDR Interest Rate

Since 1981, the SDR interest rate has been set as a weighted average of market interest rates. The interest rates are those on the least risky short-term (three-month) investments in the currencies in the SDR valuation basket, and the weights used correspond with the weights of these currencies in the basket.¹ The SDR interest rate therefore approximates the market rate on investments in the basket of currencies used to value the SDR. The rate is adjusted weekly.

Rate of remuneration

Since 1987, the rate of remuneration has been set equal to the SDR interest rate, but is adjusted downward to generate resources under the burden-sharing mechanism.² The adjustment is subject to the provision in the *Articles* that the rate of remuneration be in the range of 80-100 percent of the SDR interest rate.

Rate of charge

The rate of charge on outstanding Fund credit is governed by Rule I-6(4), which stipulates that the rate be determined as a proportion of the SDR interest rate on the basis of the estimated income and expense of the Fund and its target amount of net income for the incoming financial year.³ The rate thus determined, called the "basic" rate of charge, is subsequently adjusted upward to implement the burden-sharing mechanism. There is a surcharge on the rate of charge for outstanding Fund credit. The surcharge rises with the amount of credit relative to quota for use of the credit tranches and the EFF. The surcharge for credit under the SRF and CCL rises with the length of time it has been outstanding.

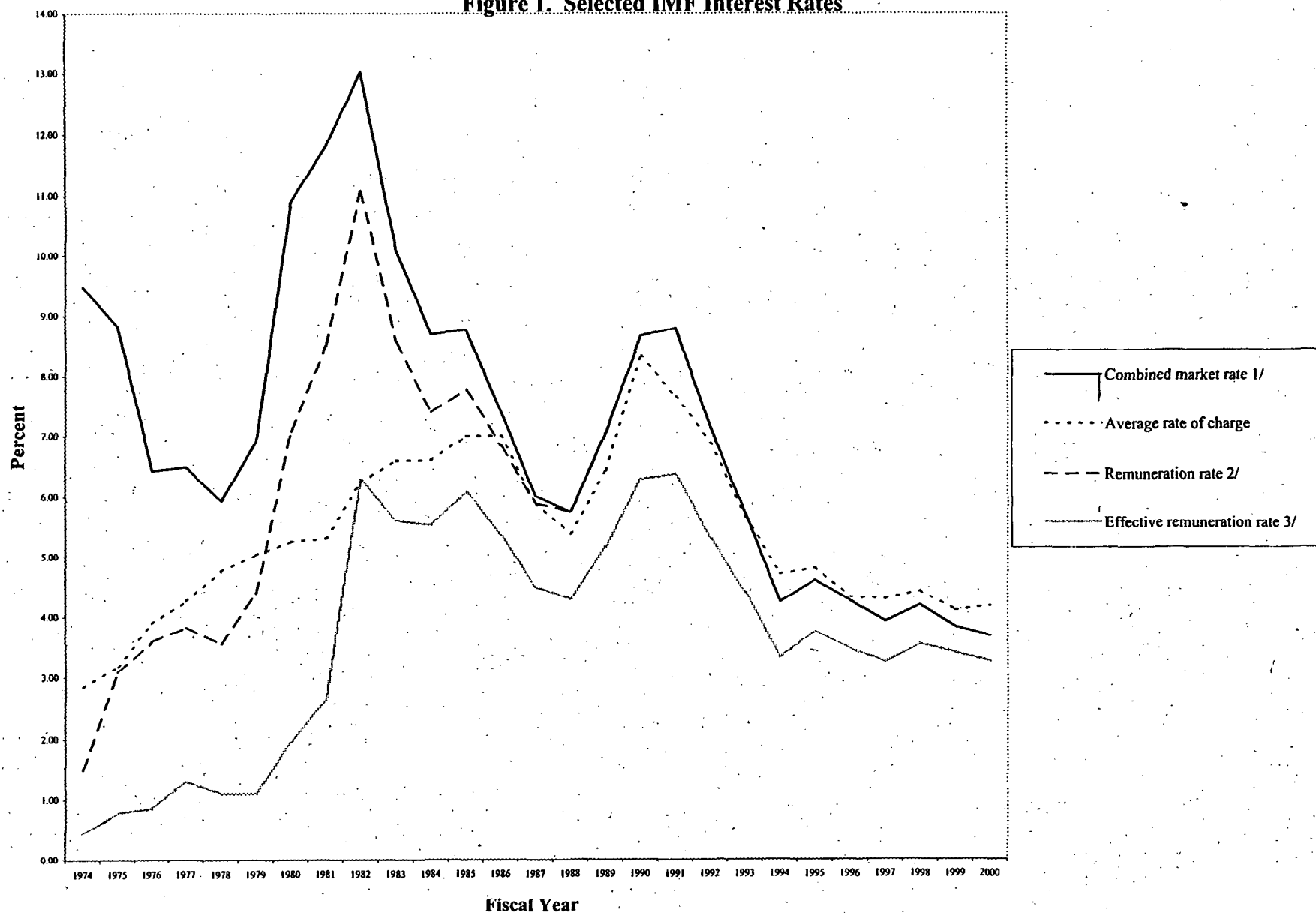
The factors affecting the rate of charge are analyzed in Appendix III.

¹ The SDR rate of interest is governed by Rule T-1(c) (see "Review of the Method of Valuation of the SDR, SM/00/180 (7/24/00)).

² The current relationship between the rate of remuneration and the SDR interest rate is governed by Rule I-10 and was agreed in 1986 in the context of the establishment of the burden-sharing mechanism (see Section IV of Decision No. 8348-(86/122), July 25, 1986).

³ Rule I-6(4) is reproduced in Appendix III.

Figure 1. Selected IMF Interest Rates



Note: The rates of charge and remuneration shown here exclude the refundable adjustments made under the burden sharing mechanism.

1/ The combined market rate is a weighted average of short-term interest rates in the major money markets, with weights corresponding to the currency weights in the SDR valuation basket. Since May 1981, the SDR interest rate has been equal to the combined (market) rate (see Appendix Table 8).

2/ Since February 1987, the remuneration rate has been set equal to the SDR interest rate (the combined market rate).

3/ Equal to aggregate remuneration payments in relation to total reserve tranche positions. The effective rate reflects the effect of the nonremunerated reserve tranche positions.

- **Since FY 1987, the rates of remuneration and charge have been subject to a “burden sharing” mechanism** that distributes among the member countries the cost arising from overdue financial obligations to the Fund (see Box 7).¹⁸ The mechanism makes up for the loss of income from unpaid (deferred) charges, and works by adjustments, downward and upward, to the rates of remuneration and charge that would otherwise be determined in the absence of such arrears to the Fund.¹⁹ In addition, the burden sharing mechanism has been used to generate resources for the Fund’s precautionary balances in the form of resources in the special contingent accounts (SCAs).

13. **The Fund’s costs are reduced by interest-free resources.** As noted earlier, these resources include the nonremunerable portion of members’ reserve tranche positions, and the precautionary balances, but are offset by gold holdings and members’ use of the nonremunerated reserve tranche (see Appendix IV).

- **A part of members’ reserve tranche positions is not paid remuneration.** This component was initially set at 25 percent of quota because members originally acquired reserve positions of that amount through quota subscriptions paid in an asset, gold, that does not earn income. As a percentage of quota, this nonremunerable portion now varies across members, reflecting changes in their relative quotas since 1978.
- **Sale of gold to the market adds to the Fund’s interest-free resources, but acceptance of gold in lieu of payments in currency or SDRs by a member satisfying its obligations to the Fund has the opposite effect.** A sale of gold to the market provides interest-free resources equal to SDR 35 per fine ounce, and the excess also provides interest-free resources in the SDA, which, among other uses, could be transferred to the GRA or invested to generate income.²⁰ Acceptance of gold in lieu of currency (or SDRs) would reduce outstanding

¹⁸ The mechanism is intended to be a temporary one, and is based on the principle that the cost arising from overdue financial obligations to the Fund should be shared among member countries. Prior to the mechanism, such cost was paid solely through increased charges on the use of Fund credit. See “The Cost of Financing the Fund and its Distribution—Review of Burden Sharing,” EBS/94/28 (2/18/94), pp. 5-7; “Cost of Fund Credit—Principles of Burden Sharing—Concessionality in Fund Operations and Related Matters—Background Material,” EBS/92/108, Sup. 1 (6/15/92), p. 4; and “Factors Relating to Burden Sharing in the Fund,” EBS/85/126 (5/14/85).

¹⁹ Contributions to cover deferred charges are not included in the Fund’s balance sheet. The members making such contributions would bear the financial effect of any ultimate failure to settle these charges (see EBS/92/108, Sup. 1 (6/15/92), Note 1, p. 2.).

²⁰ See “Reforming the Financial Structure of the Fund—The Role of the Variable Uniform Norm,” EBS/94/139 (7/5/94), p. 5.

Box 7. The Burden-Sharing Mechanism

1. In effect since 1986, the burden-sharing mechanism makes up for the loss of income from deferred or unpaid charges, and has collected resources placed in two special contingent accounts. The mechanism works by providing for additions and deductions to the rates of charge and remuneration, respectively.
2. Resources collected from individual members under the mechanism are refundable to them as arrears cases are resolved, or as may be decided by the Fund. Thus, resources collected for deferred charges are refunded when such charges are subsequently settled by members in arrears. Cumulative deferred charges amounted to SDR 1,776 million at the end of FY 2000.¹ Of this total, settlements of unpaid charges of SDR 971 million have been made and refunded.
3. Of the two special contingent accounts, the first, SCA-1, was established specifically to protect the Fund against the financial impact of arrears. The second, SCA-2, which has been dissolved, collected resources to finance the encashment of "rights" by eligible members with arrears to the Fund to later draw on the Fund, and to safeguard the Fund against the risk of loss arising from purchases made in connection with the encashment of rights.²
4. In the aggregate, creditor and debtor members, respectively, contribute equal amounts for unpaid charges and for contributions to SCA-1, whereas creditors provided three-fourths of the amounts contributed to SCA-2. A total of SDR 1.1 billion has been accumulated in SCA-1. A total of SDR 1 billion was accumulated in 1990-97 in SCA-2.
5. Criticism of the burden-sharing mechanism centered on two aspects. First, members that are neither debtors nor creditors do not provide resources under the mechanism. Second, the distribution of the burden among members can diverge sharply from a more "equitable" one based, for example, on indicators of their potential rights and obligations, such as Fund quota shares. Alternative quota-based burden sharing mechanisms proved, however, to be either prohibited by the *Articles*, e.g., a quota-based levy; or impractical, such as a voluntary contribution scheme; or did not receive the required support of the membership, such as a gold sale.

¹ The resources collected to cover deferred charges do not add to the Fund's precautionary balances.

² The SCA-2 was terminated in 1999, and the balances in the account refunded, in light of an assessment that the Fund's other precautionary balances provided adequate protection against risks associated with rights-related credit, and as part of an overall agreement on the financing of the then-ESAF (now PRGF) and HIPC initiatives, for which it was envisaged that members would voluntarily contribute resources refunded from SCA-2. See "An Early Termination of the Second Special Contingent Account (SCA-2) and the Future of the Rights Approach," EBS/99/155 (8/13/99). On the "rights approach," see "Overdue Obligations to the Fund—Operational Modalities of the 'Rights' Approach," EBS/90/102 (5/29/90), and summing up by the Chairman of EBM/90/97—June 20, 1990.

Fund credit without a corresponding reduction in members' reserve tranche positions (or increase in SDR holdings of the Fund), and consequently would reduce the Fund's net income.²¹

14. Administrative expenses constitute the Fund's main fixed cost of operation. These expenses are normally paid through the use of Fund's holdings of U.S. dollars, and include costs incurred in administering the two departments (General and SDR) and the administered accounts. The GRA is, however, reimbursed for the cost of administering the SDR Department, which is financed by assessments levied on the participants in the SDR system,²² and by the SDA for the cost of administering the SDA. Until FY 1997, the GRA was also reimbursed through the SDA for the cost of administering the then ESAF (now PRGF) Trust.²³ Table 2 provides summary data on administrative expenses for FY 1996-2000.

15. The differential between the rate of charge and market interest rates tends to move inversely with the level of outstanding Fund credit. The "charge coefficient," or the ratio between the rate of charge and the SDR interest rate, is determined in a manner consistent with the target amount of net income. Because administrative expense and additions to precautionary balances are relatively fixed in the short run, and payments for remuneration are directly related to the size of outstanding Fund credit, the rate of charge moves inversely with the stock of outstanding credit.²⁴ This relationship also partly explains the fluctuation over time in the charge coefficient. In addition, the charge coefficient also tends to move inversely with the SDR interest rate which determines the implicit value of the Fund's interest-free resources.

C. Distribution of the Cost of Operating the Fund

16. The overall incidence of the cost of operating the Fund on various members is not readily apparent, and has been controversial. The traditional analysis by the staff of the various cost and revenue elements, presented in Table 3, assumes that administrative expenses and target net income are effectively financed by debtors, whereas the imputed cost

²¹ Combining a sale of gold and its acceptance results in a loss of income in the GRA that is offset by investment earnings in the SDA. See "Financial and Operational Modalities of Off-Market Transactions in Gold by the Fund," EBS/99/176 (9/15/99), and EBS/00/70 (4/7/00), p. 23.

²² The annual assessment in the SDR system is based on the estimated cost of operating the system and is collected in proportion to participants' net cumulative SDR allocations (Article XVI, Sec. 2).

²³ The Fund has decided to forego such reimbursements for FY 1998-2004 as part of its contribution to the financing of the PRGF and HIPC Initiatives (see the Managing Director's statement in BUFF/99/126, 9/30/99 rev.).

²⁴ See Appendix III for a mathematical discussion. For earlier analyses, see EBS/85/126 (5/14/85), pp. 17-18; EBS/94/28, pp. 12-13; EBS/94/139 (7/1/94), pp. 3-5; and EBS/94/235 (12/6/94), p. 3.

Table 2. The Fund's Administrative Expenses, FY 1996-2000

(In millions of U.S. dollars unless otherwise indicated)

	Financial Year				
	1996	1997	1998	1999	2000
Administrative budget expenditure	470.8	471.6	495.3	520.6	583.0
Capital budget expenditure 1/	34.8	151.5	56.1	43.9	39.3
Total budget expenditure	505.6	623.1	551.4	564.5	622.29
<i>Reconciliation</i>					
Less: SDR Reimbursements	-5.8	-5.9	-6.0	-4.8	-4.5
SAF/PRGF Reimbursements	-35.6	-43.8			
Assets capitalized 2/	-31.0	-139.0	-48.0	-28.9	-21.8
Prepayment of SRP			-16.3	-17.3	-23.2
Add: Depreciation expense 3/	8.8	11.2	15.8	19.7	22.8
Pension expense under IAS 19					10.8
Total administrative expenses	441.9	445.6	496.9	533.2	606.4
Breakdown of major activities (in percent of total administrative expenses)					
Surveillance	27.5	27.8	28.5	28.3	26.0
Use of IMF resources	23.9	25.7	21.1	22.0	21.0
Administrative support	18.8	18.9	18.2	16.7	20.0
Technical assistance	14.8	14.1	16.5	17.0	19.0
Board of Governors and Executive Board	10.7	9.9	11.0	11.0	9.0
External relations	4.3	3.6	4.7	5.0	5.0
	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>
<i>Memorandum items:</i>					
Total administrative expenses, in millions of SDRs 4/	301.3	316.8	368.5	392.1	448.4
Total administrative expenses, in percent of total quotas	0.21	0.22	0.25	0.19	0.21

NOTE: Budget expenditure represents actual disbursements, whereas administrative expenses, as presented in the Fund's financial statements, reflect the "reconciliation" items shown in this table.

Sources: Office of Budget and Planning; Treasurer's Department; IMF *Annual Reports*; and staff estimates.

1/ Capital budget disbursements reflect the definition of capital projects for budget management and control purposes, and may differ from the presentation of assets capitalized in accordance with generally accepted accounting principles in the Fund's audited financial statements.

2/ Assets capitalized include costs in excess of \$100,000 for land, buildings (including work in progress), leasehold improvements, and equipment (including EDP).

3/ Depreciation is calculated using the straight-line method over the estimated useful lives of the assets.

4/ As per *Annual Report*. Converted to SDRs using the actual US\$/SDR exchange rate in effect when the disbursements were made.

Table 3. Costs of Financing the Fund's Administrative Expenses and Precautionary Balances
and Relative Burden on Members, FY 1982-2000 ^{1/}

(In millions of SDRs and percent)

Items in Excess of Remuneration Expense and Cost of Borrowing							Debtors' Share			Creditors' Share			Relative Contribution (in percent) ^{4/}	
FY	Adminis- trative expenses	Net income	Deferred charges	SCA-1	SCA-2	Total actual cost	Charges in excess of net opera- tional expenses ^{2/}	Burden- sharing contributions	Sub- total	Imputed costs - NRT ^{3/}	Burden- sharing contributions	Sub- total	Debtors	Creditors
1982	153.3	92.1	--	--	--	245.4	245.4	--	245.4	641.4	--	641.4	27.7	72.3
1983	191.4	65.4	--	--	--	256.8	256.8	--	256.8	497.0	--	497.0	34.1	65.9
1984	192.8	73.0	--	--	--	265.8	265.8	--	265.8	436.4	--	436.4	37.9	62.1
1985	224.2	(29.8)	--	--	--	194.4	194.4	--	194.4	478.2	--	478.2	28.9	71.1
1986	223.4	78.1	--	--	--	301.5	301.5	--	301.5	411.9	--	411.9	42.3	57.7
1987	190.9	86.0	182.2	26.5	--	485.6	276.9	117.7	394.6	349.3	91.0	440.3	47.3	52.7
1988	175.1	49.1	153.7	60.4	--	438.3	224.2	107.1	331.3	340.0	107.0	446.9	42.6	57.4
1989	172.7	54.2	224.8	62.9	--	514.6	226.9	144.0	370.9	413.6	143.8	557.4	40.0	60.0
1990	188.6	85.5	235.3	65.0	--	574.4	274.1	150.2	424.3	502.0	150.1	652.1	39.4	60.6
1991	189.4	69.9	210.3	69.8	142.3	681.7	259.3	181.6	440.9	500.9	240.8	741.7	37.3	62.7
1992	232.2	89.9	190.0	73.4	156.3	741.8	322.1	189.3	511.4	398.0	230.4	628.4	44.9	55.1
1993	263.3	70.6	139.4	78.3	177.0	728.6	333.9	172.1	506.0	342.7	222.6	565.3	47.2	52.8
1994	318.0	74.1	94.1	82.0	161.2	729.4	392.1	139.6	531.7	271.1	197.7	468.8	53.1	46.9
1995	288.3	85.1	96.0	85.2	130.3	684.9	373.4	101.4	474.8	293.8	210.1	503.9	48.5	51.5
1996	301.3	89.3	64.4	92.0	174.2	721.2	390.6	92.0	482.6	271.4	238.6	510.0	48.6	51.4
1997	316.8	93.8	47.4	94.8	58.6	611.4	410.6	82.8	493.4	251.2	118.0	369.2	57.2	42.8
1998	368.5	163.8	48.7	99.4	--	680.4	532.3	74.6	606.9	266.3	73.5	339.8	64.1	35.9
1999	392.1	435.6	42.4	107.4	--	977.5	827.7	74.8	902.5	243.2	75.0	318.2	73.9	26.1
2000	448.4	267.7	42.4	128.5	--	887.0	716.1	85.9	802.0	239.8	85.0	324.8	71.2	28.8

1/ This table is based on the following assumptions: (a) the Fund's "cost of funds," i.e., its payments to creditors, are *excluded*, and the table attempts to quantify the relative contributions of debtor and creditor members to financing the Fund's "other costs," which are defined to be equal to the total of the first five items (administrative expenses, net income, deferred charges, SCA contributions) plus the imputed cost of the non-remunerated reserve tranche positions; (b) debtor members are assumed to finance administrative expenses and net income (because of the method of determining the rate of charge); and (c) creditor members pay for the imputed cost of the nonremunerated reserve tranche positions (i.e., the table assumes zero holdings of nonremunerated reserve tranche positions by debtor members). For a discussion of the method of attributing debtor and creditor contributions, see EBS/94/28 (2/18/94), pp. 12-16.

2/ Contribution by debtors through charges in excess of the amount needed to cover remuneration expense and the cost of borrowing. This is equivalent to the total of administrative expenses and net income.

3/ Cost of holding the nonremunerated reserve tranche (NRT) is calculated at the average rate of remuneration in effect each year.

4/ Based on the total of actual and imputed costs.

of nonremunerated reserve tranche positions is paid by creditors.²⁵ Separately, contributions to the SCAs are shared explicitly between creditors and debtors according to the decisions taken under the burden-sharing mechanism. The staff's analysis suggests that the relative contribution of creditor and debtor groups varies over time and does not reflect their relative quota shares. The relative contribution of debtor members has risen to about 70 percent in recent years, compared with their quota share of about 30 percent. The rise in the debtor members' relative contribution reflects mainly the increase in administrative expenses that has not been matched by the imputed cost of nonremunerated reserve tranche positions.

17. **The measurement of creditor and debtor contributions is not a straightforward matter, as it requires a benchmark for measurement.** In Table 3, the creditor countries' contribution is measured in part on the basis of the downward adjustment, under the burden sharing mechanism, of the rate of remuneration from the (market) SDR interest rate, whereas the debtor members' contribution is measured on the basis of the excess of the rate of charge over the (market) SDR interest rate. In discussions in 1994, some Directors remarked that the rate of charge was *lower* than the debtor members' opportunity cost (i.e., the interest rate at which such members could obtain credits in the private market), and from this perspective, debtor members enjoyed a subsidy on their credit from the Fund. This measurement issue also figured in the debate on the extent of concessionality in Fund lending (see paragraph 21 below).

18. Apart from measurement problems, the **factors affecting the incidence of the cost of operating the Fund** include the level of market interest rates, the size of the Fund's interest-free resources, its target net income, and its administrative expenses. The contribution of creditor members is positively related to the level of market interest rates and the size of interest-free resources in the form of unremunerated reserve tranche positions. As regards the debtor members' contribution, under the existing system, a larger sum of administrative and prudential expenses is paid for at the margin by higher charges on use of Fund credit, thereby raising debtor members' relative contribution (or, alternatively, reducing their implied subsidy).

III. PROPOSALS TO MODIFY THE STRUCTURE AND OPERATION OF THE FUND'S FINANCES

19. **Incorporated in the structure and operation of the Fund's finances are elements of compromise, the result of attempts to reconcile possibly conflicting objectives.** The Fund aims to encourage members to undertake early economic adjustment, to give incentives for early repayment, to provide creditor countries with a competitive rate of return, and to maintain balance in its income position (especially after the emergence of arrears in the mid-1980s). Reform efforts have focused on the degree of concessionality of Fund credit and on the issue of "equity" in the sharing of its costs. These efforts were also made in the wake of changes in the Fund's costs, including the increase in the rate of remuneration to the level of

²⁵The assumptions underlying Table 3 are taken from EBS/94/28 (2/18/94), pp. 12-13. For further analytical treatment of the Fund's cost/revenue structure and the incidence of its costs, see EBS/94/139 (7/1/94); Attachment II; and "Reforming the Financing of the Fund's Operations," EBS/94/235 (12/6/94).

market interest rates. Criticism that the method of determining the Fund's rate of charge was complex, unpredictable, time-consuming, and/or divisive also raised the issue of transparency in the Fund's finances. This section reviews the various reform proposals, and the Executive Board's views on their relative merits. Table 4 classifies the main proposals according to whether they require amendment of the *Articles* and gives the voting majorities required for their adoption.

A. Concessional, Incentives, and Maturities

20. **The appropriate degree of concessionality in the Fund's lending arises as an issue in proposals on the rate of charge or the maturity of Fund credit.** This is because Fund charges are lower than the cost of alternative (market) sources of finance for debtor members, reflecting the effect of the Fund's interest-free resources and the rate of remuneration being pegged to the borrowing cost of the Fund's largest and most creditworthy member countries. A related question is that of whether maintaining an element of concessionality in the Fund's lending is consistent with prudent financial management, which includes the objective of making the Fund's resources revolve, or in the long-run interest of the Fund. Proposals that bear on concessionality include: (a) incorporating a risk premium or surcharge to the rate of charge; (b) rebating the surcharge as the indebted member makes repayments; and (c) imposing a rate of charge at a premium over the short-term SDR interest rate to reflect the longer maturity of Fund credit.

21. **Concessionality has at least two dimensions, its appropriate level and its measurement.** The first dimension relates to the differentiated conditions of Fund lending to middle-income countries compared with that to low-income countries.²⁶ Debtor countries have argued that a below-market rate of charge is appropriate because of the public good aspects of Fund financing, and the role of conditionality as a nonfinancial cost that reduces the risk in Fund lending.²⁷ The other dimension relates to the benchmark for measuring concessionality. Traditionally, as estimated by the staff using market interest rates on international reserves as a benchmark, concessionality in the rate of charge has varied over time, rising sharply in the late 1960s and early 1980s when the rate of charge failed to keep pace with market interest rates, but turning negative in recent years (see Appendix V). However, concessionality can also be measured on the basis of the borrowing costs faced by debtor members, in which case the Fund's normal lending continues to provide a significant concessional element.

22. **Suggestions were made to incorporate an explicit risk premium or a surcharge to the rate of charge.** Under the existing system, a de facto surcharge relative to the SDR interest rate is embedded in the rate of charge required to generate the targeted accumulation

²⁶ Highly concessional lending has generally been justified as a means of supporting the adjustment efforts of low-income countries with financing terms consistent with their debt-servicing capacity (see EBS/94/28 (2/18/94), pp. 10-13).

²⁷ These considerations were raised in 1994 and reviewed in EBS/00/37 (3/2/00), pp. 53-54.

Table 4. Summary of Proposals on the Structure and Operation of the Fund's Finances

By Principal Objective	Need to Amend the Articles ^{1/}	Majority Required for Adoption ^{2/} (in percent of total voting power)
I. Adaptations of concessionality		
1. Risk premium or surcharge to the rate of charge	No	70
2. Rebating the surcharge	Yes	...
3. Premium for maturity transformation	No	70
II. Equity considerations		
1. Uniform adjustable norm	Yes	...
2. Burden sharing on overhead cost	No	70
3. Voluntary contributions	No	n.a.
4. Annual levy	Yes	...
5. User fees for technical assistance	No	Simple
6. More accurate costing of SDR system and PRGF-HIPC Trust	No	Simple
III. Robustness of mechanism		
1. Reducing the SDR interest rate	No	70
2. Reducing the floor for the rate of remuneration	Yes	...
3. Sale of gold	No	85
4. Uniform adjustable norm	Yes	...
IV. Simplification and transparency		
1. Consolidation of precautionary balances	No	... ^{3/}
2. Less frequent decisions on income issues	No	Simple
3. Merging the General and SDR Departments	Yes	...
4. Revision of financial statements	No	Simple
5. Expanded financial transactions information on Fund website	No	Simple

^{1/} Amendment of the Articles requires approval by the Fund's Board of Governors by a majority of votes cast and acceptance by three-fifths of the members having 85 percent of the total voting power.

^{2/} Simple majority refers to majority of votes cast.

^{3/} Requires consent of all contributors to SCAs. Consolidation of general with special reserves requires simple majority.

of precautionary balances. In addition, an explicit surcharge applied to the existing rate of charge, suggested in 1994, could vary by facility, or rise according to the extent of use of Fund credit and/or the length of time that such credit has been outstanding, thereby discouraging use of credit in unduly large amounts or for unduly long periods.²⁸ The idea of a surcharge was not accepted in 1994, but was revisited and agreed later, in 1997 and 1999, when the Fund established the SRF and the CCL, respectively. In these facilities, the surcharge depends on the length of time the credit has been outstanding (see Box 3 above), thereby giving incentives for early repayment. In 2000, the Executive Board also agreed on a level-based surcharge on use of the credit tranches and under the EFF, while differentiating the surcharge agreed for the CCL from that on the SRF. The Board noted its intention not to revise the new system of surcharges until 2004.

23. The Fund has also modified the repayment terms of Fund credit, establishing facilities with shorter maturities, and formalizing the expectation that a debtor member would repay as soon as its external position recovers. The recently established SRF and CCL deal with short-term disturbances in members' capital accounts, from which a relatively swift recovery is expected. Credit under these facilities is expected to be repaid in 1-1 ½ years (extendable to 2-2 ½ years). Repurchase maturities in the credit tranches, EFF, and the CFF were reviewed in 2000 in the recently concluded review of Fund facilities. Such credits are expected to be repaid earlier than their obligation dates, provided that the borrowing member's external position had strengthened sufficiently, enabling early repayment without undue hardship or risk.²⁹ The Executive Board agreed to review the operation of expectations on early repayments by November 2005.

B. Equity Considerations

24. "Equity" in the financing mechanism, though difficult to define, has generally been viewed in terms of how the burden of the Fund's cost is paid by individual members, or shared between such groups of members as debtors, creditors, and other members (called "neutral" members, that do not participate actively in Fund transactions by virtue of maintaining the Fund's holdings of their currency exactly equivalent to quota).³⁰ Many Directors supported cost sharing on the basis of quotas, which they viewed as a reasonable indicator of members' rights and obligations. The equity issue is conjoined with that of concessionality, as it was also discussed in the context of how the differential between the

²⁸ A number of other variants of a surcharge scheme were suggested in 1994 (EBS/94/235 (12/6/94), pp. 6-8). One proposal would rebate the surcharge as the debtor member completes repurchases (the rebate would have been similar to the refund of contributions made by debtor members to burden sharing). Another variant was that of incorporating a term-structure premium into the rate of charge to reflect the maturity transformation undertaken by the Fund.

²⁹ The obligation dates of 3 ¼ - 5 years for credit tranche purchases and 4 ½ - 10 years for EFFs were not changed. As indicated in Box 3, the corresponding expectation dates are 2 ¼ - 4 years for credit tranche use and 4 ½ - 7 years for EFFs.

³⁰ A broader concept of equity may also be considered, taking into account the distribution of *benefits* of the Fund to its members.

rate of charge and the rate of remuneration is determined. Proposals that may be classified as addressing equity issues include: (a) the proposal for a uniform variable or adjustable norm (suggested by an Executive Director in 1992); (b) extending the mechanism of burden sharing to the Fund's fixed expenses; (c) voluntary contributions, especially from neutral members; (d) an annual levy on all members; (e) imposition of user fees for the various services of the Fund, including technical assistance; and (f) undertaking a more accurate assessment of the reimbursable costs of operating the SDR Department and the PRGF/HIPC Trust. It may be noted that proposals (a) and (d) require amending the Articles.

25. The proposal for a **uniform adjustable norm**, described in Box 8, would have distributed the burden of financing the Fund's fixed costs (administrative expense and all or part of additions to precautionary balances) to all members according to quota shares.³¹ The proposal foundered in 1995 in part because of disagreement on whether and to what extent additions to precautionary balances would be financed by the adjustable norm. An impetus behind the proposal, a perception of inequity within the group of creditor members with respect to their shares in financing the outstanding stock of Fund credit also no longer applies. The Fund decided in 1998 to allocate creditor participation in the financing of Fund credit according to relative quotas (see Box 2 above).

26. **Extending the mechanism of burden sharing to the Fund's "overhead" expenses** would have the same broad effect as the proposal for a uniform adjustable norm but without amending the Articles.³² This proposal envisaged that the rates of charge and remuneration would initially be set equal to the SDR interest rate, and then adjusted, as under burden sharing, so as to distribute the burden of financing the Fund's remaining expenses (administrative expense and its additions to precautionary balances, less the effect of the Fund's interest-free resources) on the basis of the aggregate quota shares of debtor and creditor members, respectively.³³ The proposal was cast as a transition mechanism, for the period before an amendment of the *Articles* could put into effect the uniform adjustable norm, but did not receive broad support. As with the uniform norm, Directors disagreed on how to define the overhead costs to be subject to burden sharing, and remained concerned

³¹ A variant of the uniform adjustable norm was a proposal for an annual levy or assessment on members to cover the cost of operating the Fund, collected in proportion to their quotas (EBS/94/28 (2/18/94), pp. 20-22). Although similar to the assessment in the SDR system, such a levy is precluded under the present *Articles*. The levy was considered impractical as it could have raised difficulties for some members to obtain parliamentary approval. A levy would also have raised anew certain issues relating to the Fund's relations with the United Nations (UN), which uses the levy method for its financing. Under the UN Charter, the Fund's status as a specialized agency of the UN would have made its administrative budget subject to review by the UN General Assembly.

³² EBS/94/28 (2/18/94), p. 17, and management statement (BUFF/94/101, 11/9/94). See also the suggestions for the "interim period" (before the *Articles* could be amended to provide for a uniform variable norm) as discussed in EBS/94/235 (12/6/94).

³³ See, in particular, EBS/94/235 (12/6/94), pp. 13-16. Because this approach adjusts the rates of charge and remuneration, the burden is shared at the individual level according to members' creditor and debtor positions, and not according to their individual shares in the total of all quotas. The adjustment downward of the rate of remuneration would remain subject to the 80 percent floor (relative to the SDR interest rate) mandated by the *Articles*.

Box 8. Adjusting the Unremunerated Reserve Tranche

1. Concerns relating to the equitable distribution across members of the cost of operating the Fund led to a proposal in 1992 for amending the Articles to provide for an adjustable portion of the reserve tranche that would be free of remuneration and would be expressed as a uniform percentage of members' quotas.¹ The Articles provide that a portion of members' creditor positions be free of remuneration, but the extent to which members hold such positions varies relative to their quotas.²
2. The proposal would require all members to hold an unremunerated reserve tranche position equal to a uniform proportion of their quotas.³ This proportion would be adjusted periodically to generate the size of interest-free resources that would permit the rate of charge to remain equal to the rate of remuneration, and the latter to remain, in turn, equal to the market (SDR) interest rate. In other words, adjustment of the norm would effectively cover the Fund's "other costs," i.e., costs other than remuneration expense. When the proposal was discussed, these costs included not only administrative expenses but also the costs of dealing with overdue obligations.
3. The attractiveness of the proposal partly reflected its simplicity: creditors and debtors would both receive and pay the market interest rate on their positions in the Fund, instead of the seemingly complex differentiated rates of charge and remuneration under the existing rules and decisions of the Fund. The proposal also had the advantage of being robust in the sense that the distribution of the burden of the Fund's nonremuneration cost would not be affected by fluctuations in market interest rates or the level of Fund credit. Furthermore, the proposal would avoid the difficulties of collecting payments from members for an annual assessment or levy.
4. Disadvantages perceived included the practical one of having to amend the Articles, the likely increase in expenses of a large number of members that were not using Fund credit or were in the process of reducing their indebtedness to the Fund, and a concern that there would be reduced discipline on the Fund's administrative expense. Creditors were concerned that, as a group, they would assume a larger share of the cost of overdue obligations, and they supported the proposal in the context of adding a surcharge to the rate of charge. Debtors, on the other hand, opposed having to pay charges on their use of the unremunerated reserve tranche (while contributing less or no longer under the burden sharing mechanism).
5. Despite intensive discussions in 1994 and 1995, the proposal did not receive the required broad support, in part because of differing views on how the cost of additions to precautionary balances should be distributed.

¹ The proposal was cast in terms of a uniform but adjustable norm for remuneration. The norm for remuneration is the difference between a member's quota and its potential nonremunerated reserve tranche position, where the latter is equal to 25 percent of the member's quota on April 1, 1978 (for members joining after that date, this portion is based on the average, relative to quota, for existing members). See Statements by Mr. Posthumus (GRAY/92/4, GRAY/94/22, and GRAY/94/230). The proposal was analyzed by staff in EBS/92/108, Sup. 1, Note 5, and was further elaborated on in EBS/94/139.

² The unremunerated portion was initially set equal to quota subscriptions paid in gold that, for the most part, the Fund held as a non-interest-bearing asset. For an individual member, this portion remains unchanged in absolute amount, but, over time, its ratio to quota diverges from that for other members because of adjustments in members' relative quota positions as a result of subsequent quota increases (see Table 7, Appendix IV).

³ Suggestions were also made to permit a member the unconditional use of the unremunerated reserve tranche, with such use bearing a cost to the member at the rate of remuneration.

that members that neither pay charges nor receive remuneration, the so-called neutral members, could not be obliged to participate in such expense sharing.

27. **Voluntary contributions** are a means of generating resources from members, unrelated to the size of their reserve tranche positions or outstanding Fund credit.³⁴ The staff illustrated this proposal by calculating loans, at zero interest, that members would extend to an administered account. The amount of the loan could be set annually at a small percentage of quota, say, one percent, less amounts already contributed by the member under burden sharing and through the operation of the unremunerated reserve tranche.³⁵ As the proposal was made to help deal with arrears to the Fund, the loans were to be repaid when the arrears problems had been resolved. The proposal did not attract serious attention because of the inherent uncertainties of a voluntary system achieving burden sharing objectives.

28. **User fees for technical assistance and other similar services of the Fund**, subject to a means test (graduated according to members' per capita incomes), were suggested as a way of reducing administrative expenses.³⁶ Services of the Fund could also be defined to include the negotiation of a Fund credit, whose cost could be captured by raising the commitment fee on use of Fund resources. The practical scope for imposing user fees is relatively small, however, given the limited means of the low-income members that tend to use Fund technical assistance services. The proposal met with little support, though the Board agreed to revisit it annually in the context of the administrative budget. Recently, the prospects for increased external funding of the Fund's technical assistance have improved.³⁷

29. A proposal that has been implemented to some extent over the years is that of having a **more accurate (and higher) assessment of the operating costs of the SDR Department and the PRGF/HIPC Trust**.³⁸ The activities of the SDR Department and the Fund's concessional lending are integral to the Fund's overall responsibilities, and their costs are initially absorbed by the GRA. The cost of the SDR Department is reimbursable from the membership at large, while that of the Fund's concessional lending is paid from the resources of the PRGF Trust (through the SDA). Improved cost recovery helped reduce pressure on the Fund's income position, and such reimbursements have generally increased at a faster pace than overall administrative expense during the 1990s. The operating cost of the SDR Department is very small, whereas that of the PRGF Trust is projected to average about SDR 52 million, or about 10 percent of total administrative expenses in FY 2000 and

³⁴ "Burden Sharing-Voluntary Loans," EBS/90/49 (3/16/90). As discussed in 1990, this proposal raised three questions: how to measure a "target" contribution by each member, how to collect such contributions, and whether the contributions could be refunded.

³⁵ Members with unremunerated reserve tranche positions would be credited with an imputed contribution.

³⁶ It was felt equitable that members receiving the benefit of particular services of the Fund, such as technical assistance, pay for the cost of such services (see EBS/94/28 (2/18/94), pp. 19-20).

³⁷ This is partly due to aid budgets resuming their growth, particularly in Europe (see, in particular, SM/00/227 (10/5/00), pp. 46-47).

³⁸ EBS/94/235 (12/6/94), p. 14, called for a "careful review" of the bases for calculating these operating costs.

FY 2001. However, the agreement reached that the GRA would no longer be reimbursed (until FY 2004) for the cost of operating the PRGF Trust was a step increase in administrative expenses in FY 1998 (see Table 2), effectively a way for the Fund to contribute to the HIPC Initiative, though its effect on the Fund's finances was offset by net income from the SRF.

C. Robustness of the Mechanism

30. **The issue of robustness of the mechanism for financing the operating cost of the Fund arises mainly from the difficulties encountered in deciding the rate of charge during the annual reviews of the Fund's income, particularly when the Fund's outstanding lending is low.** These difficulties also stem from the 70 percent majority of the total voting power required for such decisions.³⁹ For example, when additions to precautionary balances were relatively large, as in 1989-96, a large part of such additions were not generated through the rate of charge but instead were made subject to the sharing rules of the burden-sharing mechanism for the two SCAs. More recently, with the loss of interest-free resources in the GRA through the sale/acceptance of gold in 2000, understandings were reached to reduce target net income as a means of slowing the increase in the rate of charge.⁴⁰

31. **The proposals that aim at a robust mechanism are framed so as to achieve agreed objectives under varying economic circumstances (i.e., regardless of the level of use of Fund credit, the size of administrative or other fixed expenses, or the level and volatility of market interest rates).** The objectives may include achieving a target level of precautionary balances and interest-free resources, or limiting the rise in the rate of charge by placing a cap on the Fund's remuneration costs. Proposals were accordingly made to modify the system of remuneration (i.e., the uniform norm proposal discussed above), sell gold, or reduce the Fund's remuneration costs (by lowering the SDR interest rate or the rate of remuneration relative to market interest rates). In general, however, these proposals have the drawback of reducing the incentives of creditor members to provide resources to the Fund, including through periodic quota increases.

32. **Reducing the SDR interest rate relative to market interest rates, while permissible under the Articles, was rejected mainly because it would diminish the attractiveness of the SDR as a reserve asset.**⁴¹ The practice of setting the rate of remuneration below the SDR interest rate (subject to the 80 percent floor) has, moreover, reduced the attractiveness for

³⁹ Creditor members with close to this proportion of total votes tend to seek to maintain the financial attractiveness of holding reserve tranche positions, and to build up the Fund's precautionary balances, while debtor members with voting shares around 30 percent of the total prefer to keep the rate of charge as low and stable as possible. In these circumstances, decisions require a compromise between the views of a potential blocking minority and those of the required majority.

⁴⁰ Remuneration expense is higher because of the off-market gold transactions (see paragraph 13 above). The target net income, set in previous years at 5 percent of the Fund's reserves, was cut, to 3.9 percent in FY 2000 and 1.7 percent in FY 2001.

⁴¹ See Statement by Mr. Posthumus, GRAY/94/22, (3/8/94).

creditor members of holding reserve tranche positions relative to holding of SDRs or other reserve assets, and reducing the SDR interest rate to permit an even lower rate of remuneration faced strong opposition from creditor countries.

33. The considerations discussed in the above paragraph also apply to **reducing the floor for the rate of remuneration to below the level of 80 percent of the SDR interest rate.** Moreover, this proposal requires amending the Articles.⁴² This proposal received almost no support.

34. **Sale of gold** would increase the Fund's interest-free resources and could be carried to the point where the Fund could cover a significant part of its overhead expenses with the imputed or actual interest income from the proceeds of such a sale.⁴³ In 1979-80, discussions took place regarding the establishment of a Substitution Account. Fund management supported the use of a (substantial) part of the Fund's gold holdings to ensure the viability of the Account, and also the sale of a small portion of the Fund's gold and use of the profits to create an investment fund and thereby strengthen the Fund's income position.⁴⁴ The question of a Substitution Account was later dropped, as was the issue of gold sale for the purpose of deriving income for the Fund. Sale of gold by the Fund remains problematic because of its possible adverse impact on the gold price and the value of central bank gold holdings. Moreover, continued gold holdings by the Fund provide certain intangible benefits, such as enhancing its ability to borrow and to protect members' claims on it, providing assurance against unforeseen contingencies, and contributing to the Fund's credibility.⁴⁵

D. Simplification

35. Efforts at **simplification (or transparency)** characterize a fourth group of proposals. Complexity arises partly from the constraints imposed by specific provisions in the Articles, such as the nonuniformity, in terms of quota, of the norm for remuneration, or the restrictions against certain transactions, such as gold leasing, or direct use of income to finance the concessional facilities. The burden-sharing mechanism also provided grounds for calls for simplification, as has comment from outside observers that the Fund be more transparent in its financial activities. Among the proposals for simplification are: (a) consolidating the precautionary balances into reserves; (b) less frequent decisions (compared with the annual cycle at present) on income-related matters; and (c) merging the General and SDR Departments. The last proposal requires amending the *Articles*. Recently, the Fund has taken

⁴² See EBS/94/28 (2/18/94), pp. 22-23.

⁴³ For a discussion of the use of gold in generating investment income, and the associated cost to the Fund of holding gold, see EBS/95/69 (4/21/95), pp. 11-14 and 21-22.

⁴⁴ Previously, in 1956-72, the Fund engaged in sale/buyback transactions in gold that resulted in investment earnings that covered the Fund's operating deficits and provided the beginnings of its special reserves. Since the second amendment of the *Articles*, such transactions are no longer permitted. See EBS/92/66 (4/7/92), Attachment II, pp. 25-26.

⁴⁵ EBS/95/69, pp. 20-21.

initiatives to expand its dissemination of financial information, to fully adopt international accounting standards (IAS), and to clarify or simplify its financial statements, discussed more fully below. These initiatives have substantially improved the transparency of the Fund's financial operations.

36. **Consolidating the Fund's precautionary balances into one reserve fund** was suggested in 1994 as a means of simplifying the various methods of financing of such balances. Although the various components of precautionary balances—general and special reserves, the SCAs—were the product of separate negotiations and compromise, it was argued that the balances all served the same goal of protecting the Fund against credit risk.⁴⁶ The proposal has not been implemented because of practical and legal impediments, among which are the refundability provisions of the SCAs and the application of general accounting principles. The latter mandates a distinction between provisions or reserves held against general credit risks from those against specific risks.⁴⁷

37. Another move toward simplicity was a proposal to make **decisions once every several years on matters relating to the Fund's income position** rather than annually.⁴⁸ Such an approach would seem more efficient in light of the special majorities required for most decisions affecting the Fund's operating cost and income. The proposal never got off the ground. Less frequent decisions require greater precision than is feasible in estimating the probability of use and repayment of Fund credit.

38. A proposal to **merge the General and SDR Departments** has been put forward to simplify and make more transparent the Fund's finances, and to modernize the Fund.⁴⁹ The merger would recognize that in both Departments, some members are "designated" as creditors that hold either SDRs or reserve tranche positions. In a merged Fund, SDRs would supplant reserve tranche positions, and be created or cancelled as the Fund extends credit or is repaid, but the currency purchase-repurchase mechanism would be dropped.⁵⁰ A further element of the proposal, which requires an amendment of the *Articles*, relates to arrangements on how the Fund pays its administrative expenses: the proposal would permit the Fund to set a rate of charge on "net users" of SDRs (those participants with SDR holdings below their SDR allocations) higher than the rate received by "net holders" of SDRs, thus allowing a margin to cover administrative (and other) costs. Furthermore, members would be obliged to hold a minimum amount of SDRs on which interest (formerly remuneration)

⁴⁶ See Statements by Mr. Newman (GRAY/94/272 (11/14/94) and GRAY/95/7 (1/5/95)).

⁴⁷ EBS/94/235 (12/6/94), pp. 8-9.

⁴⁸ This proposal was suggested by staff in October 1994.

⁴⁹ See Jacques J. Polak, "Streamlining the Financial Structure of the International Monetary Fund," *Essays in International Finance*, No. 216 (Princeton, NJ: International Finance Section, Department of Economics, Princeton University, 1999).

⁵⁰ An intermediation technique similar to SDR designation would replace the Fund's purchase-repurchase mechanism. SDRs could still be created through allocation as under the present *Articles*.

would not be paid.⁵¹ These arrangements are a variant of the adjustable uniform norm proposal.

39. **The proposal to merge the two Departments does not fundamentally alter the financing mechanism of the Fund** though it would enhance transparency by eliminating the Fund's specialized terminology—the so-called “currency veil” on its transactions. However, the recently adopted changes in the format of the Fund's financial statements (see below) have to some extent also achieved greater transparency. Furthermore, the proposal retains the role of quotas in determining the potential supply of and demand for Fund resources, including those in the SDR system. This would not necessarily make agreement on new quota increases or SDR allocations less difficult. The proposal also seeks, in part, to address an equity problem that has been resolved with the 1998 decision to allocate creditor participation in the financing of Fund credit on the basis of quotas (see paragraph 25).

40. **Beginning with FY 2000, the Fund's financial statements are presented in full compliance with International Accounting Standards (IAS) and have been revised to enhance completeness and transparency.**⁵² To enhance transparency, the balance sheet was revised to disaggregate, on the asset side, the Fund's holdings of currencies and securities into three main components (credit to members, usable currencies, and other currencies). The liabilities side of the balance sheet was also broken down into reserve tranche positions and other subscription payments. The income statement was revised to recognize the accounting gain from the increase in market value of the Fund's staff retirement plan investments, show the profits from the Fund's (off-market) gold transactions, and expand the information content in the notes to the statement. Furthermore, as required by IAS, a cash flow statement was added. Separately, the Fund shifted the responsibility for the audit of its accounts from an External Audit Committee (EAC) to an external audit firm overseen by the EAC.

41. **The Fund's website now has substantially expanded information on its finances.** Since mid-2000, the Fund has regularly published data on the sources, by member country, of financing for its quarterly lending operations, as well as details on member countries' borrowings from the Fund. The data on supply of resources to the Fund (the financial transactions plan) are now updated quarterly, and data on the demand for resources (IMF financial activities) and overall liquidity are updated weekly. Data on individual members' financial relations with the Fund (positions in the General and SDR Departments, status of

⁵¹Holding less than the minimum balance (which would be equivalent to using all or part of the unremunerated reserve tranche position under the present *Articles*) would require an interest payment from the member to the Fund.

⁵² See “Audited Financial Statements for FY 2000,” EBAP/00/73, (6/19/00). The International Accounting Standards Committee (IASC) issued a comprehensive revision of IAS 19 (on the method of accounting for post-retirement benefits), which requires employers to recognize on the balance sheet the difference between actuarially determined pension plan liabilities and the fair value of pension plan assets, and prescribes a specific method for valuing plan assets and liabilities. Compliance with IAS 19 resulted in a significant nonrecurring gain in the GRA because the market value of investments of the Fund's staff retirement and benefits plans exceeded the net present value of the associated benefits. The revised IAS also requires the accounts of the Fund's staff retirement and benefits plans to be included in the Fund's balance sheet (see “International Accounting Standard 19—Accounting for Pension Benefits in the Fund,” EBS/99/62, (4/21/99)).

stand-by and extended arrangements, and outstanding and projected obligations to the Fund) are available monthly, and data on IMF exchange rates and interest rates are updated daily and/or weekly, as appropriate.⁵³ Discussion of changes to the Fund's lending policies, such as those agreed in the recent review of the Fund's facilities, has also been publicized through the website.

IV. CONCLUDING REMARKS

42. **The Fund's financial structure reflects its character as a cooperative and its unique role in the international financial system.** The Fund's capacity to respond quickly to members' needs rests on the obligation of its creditor members to make their currency subscriptions fully available, and, in addition, the Fund has considerable leeway in setting the financial terms and conditions of its lending. But the Fund is constrained by provisions in the *Articles* governing its financial operation, including the requirement of a broad consensus to effect any reforms of its finances. Tasked with promoting economic adjustment by members through its lending, the Fund also has to safeguard its resources by providing incentives for early repayment, and maintaining precautionary balances.

43. **The Fund's finances are broadly comparable with those of other financial institutions.** On its balance sheet, the Fund holds claims on debtor members, financed by the creation of liabilities to creditor members in the form of reserve tranche positions. Its capital includes the usable component of its subscribed quota resources, augmented by its precautionary balances (reserves and special contingent account resources). The Fund may also borrow to supplement its subscribed resources. The Fund continues to hold gold as an asset but does not normally use it in its operations and transactions.

44. **The cost-revenue structure of the Fund contains fixed and variable elements.** The costs of operating the Fund include remuneration payments to creditors that are directly related to (fluctuating) market interest rates, and relatively fixed administrative and prudential expenses. The Fund does not rely on member contributions to defray its operating costs, although it benefits from the presence of interest-free liabilities and reserves. The Fund's operating revenue from interest receipts is determined by the setting of a rate of charge on Fund credit consistent with a net income target. This rate of charge also tends to follow the fluctuations of market interest rates. Such a "market-cost-plus" character of Fund lending is in keeping with its nature as a financial cooperative.

45. **Although the Fund's financing mechanism is simple, complications have arisen over the years,** particularly in dealing with the effects of arrears to the Fund. The arrears situation prompted the establishment of the burden-sharing mechanism, which provides for explicit contributions from creditors and debtors to the Fund's precautionary balances, and deviates from the simplicity of determining the rate of charge on the basis of the Fund's net income target. Also, the Fund's response to special problems, such as those of the debt of low-income countries, has resulted in difficult compromises and some complexity in the treatment and accounting of the profits on gold sales.

⁵³ See <http://www.imf.org/external/fin.htm>.

46. **Substantial gains in transparency and simplicity regarding the Fund's finances have recently been made** through the new format for its financial statements, its adoption of international accounting standards, the shifting of responsibility for audit of the Fund's accounts to an external audit firm, and the expansion of availability of information on the Fund's finances on its website. Simplicity has also been enhanced with the 1998 decision to use quota shares for determining creditor members' participation in the financing of the Fund. Moreover, the complexity of the burden-sharing mechanism would be eliminated once the few remaining arrears cases are settled.

47. **Recent changes in the financial terms and conditions of Fund credit provide incentives that strengthen the revolving character of Fund resources** by discouraging the use of credit for excessively long periods or in excessively large amounts. The Executive Board agreed in 2000 that members are expected to repay use of the credit tranches, or under the EFF and the CFF, ahead of their obligatory maturity dates, if their external positions permit. This change, together with the establishment of short-term credits under the SRF and CCL, is intended to reduce the effective maturity of Fund credit. The Board also agreed to apply a surcharge on the rate of charge on use of the credit tranches and under the EFF, with the surcharge depending on the size of the outstanding credit (a surcharge based on the length of time the credit has been outstanding had earlier been agreed for SRF and CCL use). To some extent, the advent of surcharges on the rate of charge addresses the concessionality and equity issues that arose in past attempts to raise the level of the rate of charge. The new system of surcharges and expectations of early repayment of credits is intended to remain in place for at least the next four years.

48. **Equity in the incidence of the cost of operating the Fund remains an issue**, particularly as regards the members in neutral positions, i.e., those members that are neither creditors nor debtors, though they account for no more than 5 percent of aggregate quotas. A means to resolve the equity issue is through a uniform but adjustable norm for remuneration, under which creditors and debtors would receive and pay the market interest rate on their outstanding positions in the Fund but the remaining costs of operating the Fund would be borne by *all* members according to their quota shares. Such a proposal, which entails amending the Articles, was discussed in 1994 but was not accepted. A large part of the equity issue was nonetheless resolved in 1998, when it was agreed that creditor members would share in financing the Fund according to their relative quota shares.

49. **Clearing all the arrears to the Fund remains an issue.** Although arrears are concentrated on only a few countries, it remains a major challenge to strengthen their efforts to establish a strong track record of policy performance and payments to the Fund, and to mobilize the necessary bilateral and multilateral financial support. **Revising the quota formulas also remains an issue**, given that revised quota shares would have important consequences for members' financial relations with, and governance of, the Fund. Alternative quota formulas will be examined by the Executive Board prior to the next general quota review to be completed by January 2003, building on the work of a group of external experts.

50. **Robustness of the finances of the Fund, in the event that total credit outstanding declines or becomes more variable, would arise as an issue.** The recently agreed changes to the Fund's lending facilities may reduce use of Fund credit on average, and result in higher rates of charge relative to market interest rates. In addition, outstanding credit and income from charges may also become more variable, as members repay sooner and as some members with access to global capital markets make use of short-term credits under the SRF or the CCL in times of crises. If such effects materialize, questions would arise concerning the acceptable extent of variability in the basic rate of charge or in net income (reserve accumulation), or concerning the burden of financing administrative expenses at low levels of Fund credit. These issues would require further consideration in due course.

THE FUND'S PRECAUTIONARY BALANCES¹

1. Historically, the Fund accumulated reserves from its net income to protect against the risk of administrative deficits and against capital loss. When overdue obligations became significant, the Fund established special contingent accounts in 1987 and 1990 to accumulate other resources of a precautionary character.
2. The Fund has generally aimed at a modest annual increase in its reserves—3 percent in FY 1981-84, 5 percent in 1985-99, 3.9 percent in 2000, and 1.7 percent in 2001. Additions to SCA-1 have been made under the burden sharing mechanism at 5 percent of reserves at the beginning of the financial year.² Accumulations in SCA-2, also under burden sharing, were made in 1990-97, achieving a target amount of SDR 1 billion, which has since been refunded to contributing members (see Table 5).
3. The staff's analysis of precautionary balances in 1993-94 concluded that it would be prudent for the Fund to maintain such balances in an amount that fully covered credit to members in protracted arrears, but that there remained a residual risk that debtor members in good standing could fall into arrears. Although difficult to quantify, such residual risk was associated with the level and concentration of credit, though contained by the effect of members' adjustment policies and by the Fund's preferred creditor status. The staff suggested that risk assessment be conducted on a country-by-country basis, taking account of factors affecting members' capacity to repay, and developing aggregate indicators of the credit risk faced by the Fund. The Executive Board was, however, reluctant to conduct such a risk assessment, partly on concerns that the country-specific risk assessments might become public.
4. Precautionary balances have, since FY 1993, covered the stock of outstanding Fund credit to members in protracted arrears. In recent Board discussions, it was agreed that the excess, called "free reserves," should be within a range of 3-5 percent of outstanding Fund credit in good standing. Free reserves have risen to 7.6 percent of credit in good standing in FY 2000, mainly because of the decline in total Fund credit.

¹ For a history of the origins of these balances, see "Preliminary Review of the Fund's Income Position for FY 1992 and 1993 and Review of Precautionary Balances," EBS/92/66 (4/7/92), Attachment II, pp. 25-31. On how the Fund assesses risk, see "The Fund's Precautionary Balances and Factors Bearing on Their Adequacy," EBS/93/84 (6/2/93); "Cost of Fund Credit—Principles of Burden-Sharing—Concessionality in Fund Operations and Related Matters," EBS/92/108 (6/15/92), pp. 8-10; "The Fund's Precautionary Balances," EBS/94/53 (3/11/94); and "Review of the Fund's Income Position, the Rate of Charge, Precautionary Balances, and Burden-Sharing for FY 2000 and FY 2001," EBS/00/70 (4/7/00).

² Except in FY 2001, where the targeted accumulation was slightly reduced.

APPENDIX I

Table 5. The Fund's Precautionary Balances and Free Reserves, FY 1950-2000

(In millions of SDRs, except as indicated)

End-FY A	Special Reserve B	General Reserve C	Total Reserves D (B+C)	SCA-1 E	Total Reserves & SCA-1 F (D+E)	SCA-2 G	Total Precautionary Balances H (F+G)	Credit to Members in Protracted Arrears 1/ I	Free Reserves J (H-I)	Memo: Free Reserves as Percentage of Credit in Good Standing
1950	-	(4)	-	-	-	-	-	-	-	-
1955	-	(12)	-	-	-	-	-	-	-	-
1960	22	40	62	-	62	-	62	-	62	14.8
1965	148	142	290	-	290	-	290	-	290	9.6
1970	366	351	717	-	717	-	717	-	717	22.2
1975	342	366	707	-	707	-	707	19	688	10.4
1980	398	366	763	-	763	-	763	19	744	8.4
1985	678	366	1,044	-	1,044	-	1,044	724	320	0.9
1990	1,032	366	1,397	215	1,612	-	1,612	2,569	(957)	[n.a]
1995	1,421	366	1,787	602	2,389	768	3,157	1,697	692	2.3
1996	1,510	366	1,876	691	2,567	942	3,509	1,106	1,461	4.2
1997	1,604	366	1,970	785	2,755	1,000	3,755	1,063	1,692	5.1
1998	1,703	431	2,134	884	3,018	1,000	4,018	1,030	1,988	4.1
1999	1,809	760	2,569	991	3,560	1,000	4,560	992	2,568	4.3
2000	2,178	927	2,837 2/	1,119	3,956	-	3,956	962	2,994	7.0

1/ Excludes Trust Fund arrears.

2/ Excludes the valuation gain from adherence to IAS. Reserves including this gain amount to SDR 3,105 million.

DECISIONS AFFECTING THE FUND'S INCOME

The special majorities required for the Executive Board's adoption of decisions affecting the Fund's income are listed below. All other decisions are taken by a majority of the votes cast.

Article	Section	Subject	Special Majorities (Proportion of Total Voting Power)
V	8(a),(d)	Determination of service charge for purchases	70 percent
V	8(b),(d)	Determination of rates of charge on holdings of currencies	70 percent
V	8(c),(d)	Imposition of charges deemed appropriate on failure to repurchase	70 percent
V	9(a)	Determination of rate of remuneration	70 percent
V	9(c)	Increase in percentage of quota as level for norm for remuneration	70 percent
V	12(b),(c)	Sale of gold	85 percent
V	12(b),(d)	Acceptance of gold instead of special drawing rights or currency in payments to Fund	85 percent
V	12(b),(e)	Sale of gold at present official price	85 percent
V	12(f)(i)	Transfer of assets of Special Disbursement Account to General Resources Account	70 percent
V	12(f)(ii), (iii)	Use of assets of Special Disbursement Account for operations and transactions not authorized by other provisions and for distribution to developing members	85 percent
V	12(g)	Transfer of proceeds of sale of gold to Investment Account	85 percent
V	12(j)	Adoption of rules and regulations for administration of Special Disbursement Account	70 percent
XII	6(d)	Distribution from general reserve	70 percent
XII	6(f)(ii)	Transfer to Investment Account of currencies held in General Resources Account for immediate investment	70 percent
XII	6(f)(vi)	Termination of Investment Account or reduction of amount of investment prior to liquidation of Fund	70 percent

Article	Section	Subject	Special Majorities (Proportion of Total Voting Power)
		Adoption of rules and regulations regarding administration of Investment Account	70 percent
XV	2	Determination of method of valuation of special drawing right other than a change in principle or a fundamental change in application of principle in effect	70 percent
		Change in principle of valuation or fundamental change in application of principle in effect	85 percent
XX	3	Determination of rate of interest on special drawing rights	70 percent
XXX	(c)(iii)	Exclusion of purchases and holdings under policies on use of Fund's general resources for purpose of calculating a member's reserve tranche	85 percent

FACTORS AFFECTING THE FUND'S RATE OF CHARGE

1. The basic mechanism underlying the determination of the rate of charge has been in place since 1981, when the rate of charge was simplified and when other decisions were taken to raise the levels of the SDR interest rate and the rate of remuneration closer to the market interest rate. This appendix discusses Rule I-6(4) and gives the mathematical properties of current and alternative approaches to determining the rate of charge.

A. How Rule I-6(4) works

2. Rule I-6(4) determines the rate of charge as the residual variable that is consistent with the Fund's other decisions on its expenses and its target net income. The Rule reads as follows:

- (4) The rate of charge on holdings (i) acquired as a result of a purchase under a policy that has been the subject of an exclusion under Article XXX(c), or (ii) that exceed the amount of the member's quota after excluding any balances referred to in (i), shall be determined in accordance with (a), (b), and (c) below.
 - (a) The rate of charge shall be determined at the beginning of each financial year as a proportion of the SDR interest rate under Rule T-1. The proportion shall be determined on the basis of the estimated income and expense of the Fund during the year, and the target amount of net income for the year. The latter shall be 5 percent of the Fund's reserves at the beginning of the year or such other percentage as the Executive Board may determine particularly in the light of the results in the previous financial year.
 - (b) A mid-year review of the Fund's income position shall be held shortly after October 31 of each year. If actual net income for the first six months of the financial year, on an annual basis, is below the target amount for the year by an amount equal to, or greater than, two percent of the Fund's reserves at the beginning of the financial year, the Executive Board will consider how to deal with the situation. If by December 15 no agreement has been reached as a result of this consideration, the proportion of the SDR interest rate under Rule T-1 determined under (a) at the beginning of the year shall be increased as of November 1 to the level necessary to reach the target amount of net income for the year.
 - (c) A review of the Fund's income position shall be held shortly after the end of each financial year. If the net income for the year just ended is in excess of the target amount for the year, the Executive Board will consider whether the whole or a part of the excess should be used to reduce the rate of charge retroactively for the year just ended, or to place all or part of the excess to reserve.

- (d) If the Fund's net income for a financial year is in excess of the target amount for that year, the Executive Board may for the purposes of the determinations and estimates referred to in (a) and (b) above in respect of the immediately subsequent financial year, decide to deem any part of the excess over the target amount that has been placed to reserve as income for that subsequent financial year.

3. Estimated expense of the Fund is determined by its decisions on its administrative budget, and by market interest rates to which the rate of remuneration is linked. The Fund's net income is also affected by the SDR interest rate and the level of its SDR holdings, as well as by the rate of charge itself, the size of outstanding Fund credit, and estimated income from surcharges on the rate of charge.¹

4. The rate of charge tends to rise, other things equal, as the stock of outstanding Fund credit falls. This is because, at the margin, the need to finance administrative expense and generate net income is spread over a smaller stock of credit outstanding.² More generally, the relationship between the rate of charge and the size of outstanding Fund credit also depends on whether the imputed interest income from the Fund's interest-free resources exceeds the sum of administrative expense and target net income (see the mathematical analysis below).

5. In the event that the 70 percent majority required for determining the rate of charge is not reached, the "charge coefficient" or ratio of the rate of charge to the SDR interest rate previously determined would remain in effect.

B. Mathematical analysis

Existing system

6. Under the existing system, the rate of charge, i_c , determined by Rule I-6(4), can be specified as:

$$i_c = \frac{i_q L_q + i_b L_b + a + n - i_R R}{C} \quad (1)$$

where C represents outstanding Fund credit; R , SDRs held by the Fund; L_q , remunerated reserve tranche positions; L_b , the Fund's outstanding borrowings; i_q , the rate of remuneration;

¹ The Fund has some leeway in determining target net income for the purpose of implementing Rule I-6(4). For example, for FY 1998 through 2001, the Fund has decided that surcharge income from the SRF (and CCL, if any) would be excluded.

² See "Factors Relating to Burden Sharing in the Fund," EBS/85/126 (5/14/85), pp. 17-18; EBS/94/28, pp. 12-13; EBS/94/139, pp. 3-5; and EBS/94/235, p. 3.

i_b , the interest rate on Fund borrowing; i_R , the SDR interest rate; a , the Fund's administrative expenses; and n , the Fund's net income.

7. While equation (1) is based on the Fund's income statement, the corresponding balance sheet identity may be written as:

$$C + R + G = L_q + L_b + N \quad (2)$$

where G represents the book value of the Fund's gold holdings and N the total of the Fund's non-interest-bearing liabilities (or "net equity").

8. The relationship at the margin between the rate of charge and the other variables that affect it also reflects the identity given in equation (2). For simplicity, let $L = L_q + L_b$, and $i = i_b = i_q = i_R$. Also, let the Fund's fixed costs (administrative expenses and target net

income) be $\hat{a} = a + n$, and let the Fund's net interest-free liabilities be $\hat{N} = N - G$. Equation (1) then becomes:

$$i_c = \frac{i(L - R) + \hat{a}}{C} \quad (3)$$

From equation (2), $L - R = C - \hat{N}$, and equation (3) becomes:

$$i_c = i + \frac{\hat{a} - i\hat{N}}{C} \quad (4)$$

The significance of interest-free resources is reflected in equation (4), which states that the rate of charge is less than, equal to, or greater than the market interest rate if the imputed income from interest-free resources is greater than, equal to, or less than the sum of administrative expenses and target net income.

From equation (4), it can also be seen that the rate of charge is positively related with the market interest rate i as long as net interest-free liabilities are below outstanding Fund credit, since

$$\frac{\partial i_c}{\partial i} = 1 - \frac{\hat{N}}{C} \quad (5)$$

9. The partial derivative of i_c with respect to C is

$$\frac{\partial i_c}{\partial C} = \frac{i \hat{N} - \hat{a}}{C^2} = \frac{i - i_c}{C} \quad (6)$$

which is negative if imputed income from interest-free liabilities is less than the sum of administrative expenses and target net income. Accordingly, the partial elasticity of the rate of charge with respect to Fund credit is:

$$\begin{aligned} \varepsilon(i_c, C) &= \frac{\partial i_c}{\partial C} \cdot \frac{C}{i_c} \\ &= \frac{i \hat{N} - \hat{a}}{i_c C} = \frac{i}{i_c} - 1 \end{aligned} \quad (7)$$

From equation (7), it can be seen that the elasticity of the rate of charge with respect to outstanding Fund credit becomes more negative as outstanding credit approaches low levels.

10. The elasticity of the rate of charge with respect to the Fund's fixed costs is:

$$\varepsilon(i_c, \hat{a}) = \frac{\hat{a}}{i_c C} \quad (8)$$

Measured in SDR terms, however, the interest paid by debtors rises one-for-one with increases in administrative expenses or in the net income target.

Alternative mechanism of an adjustable norm

11. Under an alternative mechanism for financing the operation of the Fund, such as the proposal for a uniform adjustable norm, the rate of charge could be set exogenously, e.g.:

$$i_c = k i_R \quad \text{for } k \geq 1 \quad (9)$$

The rate of charge would thereby be invariant with respect to the level of outstanding Fund credit but would continue to fluctuate with market interest rates. The extent to which k would exceed 1 would be a more or less permanent determination of the premium or surcharge that the rate of charge would have vis-à-vis market interest rates.

12. What would be determined endogenously under the adjustable norm proposal would be the size of interest-free resources, \hat{N} , which can be expressed as:³

$$\hat{N} = (1-k)C + \frac{\hat{a}}{i} \quad (10)$$

The required size of interest-free resources would be positively related with the size of administrative expenses and target net income, and inversely related with the size of Fund credit outstanding (for $k > 1$), and with the level of market interest rates. The value for \hat{N} would, however, be invariant with respect to the level of Fund credit if k is set equal to 1.

³ Equation (10) can be derived by re-arranging equation (4), with $i_R = i$.

The Fund's Interest-Free Resources

1. The Fund's gross interest-free resources in the GRA comprise three main components: the excess of quotas over members' norms (which represent the potential total of nonremunerated reserve tranche positions), cumulative net income (placed in the Fund's reserves), and resources in the special contingent accounts (see Table 6). Part of these resources are absorbed by members' use of their nonremunerated reserve tranche positions and by the Fund's gold holdings. The remaining balances represent interest-free resources available for use in extending Fund credit.
2. The Second Amendment in 1978 established, for each member, a portion of the reserve tranche position on which the member would not receive remuneration. This amount is equal to quota less the "norm" for remuneration (Table 7). Members' potential unremunerated reserve tranche positions were originally equal to 25 percent of total quotas, being the counterpart of gold paid in quota subscriptions, given that the norm was initially set at 75 percent of quota. The average norm for remuneration has since risen to 96 percent of quota.¹ The *Articles* provide for the unremunerated portion to be reduced or eliminated (through an increase in members' norms), but not increased.
3. The Fund's holdings of the currencies of creditor members are typically below their norms for remuneration, i.e. creditor members typically maintain an unremunerated reserve tranche position.² Other members, subject only to representation of need, may, through a reserve tranche purchase, draw down their reserve tranche positions and thereby contribute less to the Fund's interest-free resources. The aggregate size of unremunerated reserve tranche positions therefore depends on the extent to which non-creditor members use their reserve tranche positions. This aggregate has fluctuated in the range of SDR 5-6 billion in the past 20 years.
4. Retained income has been built up from negative levels in the 1950s, when the Fund had operational deficits, to some SDR 2.8 billion at the end of FY 2000. Retained income placed in the Fund's reserves includes SDR 424 million of gold investment income generated in 1957-72.³

¹ The potential unremunerated portion of a member's reserve tranche position (equal to quota minus the norm) remains unchanged in absolute SDR amount even as the member's quota is later increased, but the norm, as a percentage of quota, would rise on average, but would vary across members to the extent that quotas are increased selectively, i.e. with variations from a uniform or equiproportional increase.

² The reserve tranche position is defined as equal to quota minus the Fund's holdings of the member's currency.

³ The Fund sold gold (subject to repurchase at the same price) and invested the proceeds in U.S. Government securities (see EBS/95/69, pp. 28-29, and EBS/92/66, pp. 25-26).

5. Resources contributed by members into the two special contingent accounts do not bear interest for them. These resources were accumulated in the late 1980s and 1990s. The SCA-2 was terminated and its balances were refunded in FY2000. The balances held in SCA-1 at the end of FY 2000 amounted to SDR 1.1 billion.

Table 6. The Fund's Interest-Free Resources in the GRA, FY 1960-2000
(In millions of SDRs and in percent)

	At end of the Financial Year								
	1960	1965	1970	1975	1980	1985	1990	1995	2000
A. Sources of interest-free resources:									
1. Subscription payments (quotas) in excess of members' norms for remuneration 1/	3,268	3,810	5,176	7,290	7,312	7,380	7,453	8,031	8,046
2. Precautionary balances	62	290	717	707	763	1,044	1,612	3,157	3,956
Of which:									
Retained income (reserves)	62	290	717	707	763	1,044	1,397	1,787	2,837 ^{2/}
Special Contingent Accounts	--	--	--	--	--	--	215	1,370	1,119
3. Excess of sundry liabilities over sundry assets 3/	(7)	(18)	(22)	43	183	--	(76)	(71)	(284)
4. Subtotal (1 + 2 + 3)	3,323	4,082	5,871	8,041	8,258	8,424	8,989	11,117	11,718
B. Uses of interest-free resources:									
5. Gold holdings 4/	2,495	2,217	2,763	5,370	3,636	3,620	3,620	3,625	5,852
6. Use of nonremunerated reserve tranche	--	--	1,882	2,163	2,327	1,302	1,643	1,643	1,513
C. Available interest-free resources (4 - 5 - 6)	828	1,865	1,226	508	2,295	3,502	3,726	5,849	4,353
As a percentage of total quotas	5.8	11.7	5.7	1.7	5.9	3.9	4.1	4.0	2.1

1/ The Fund has paid remuneration on members' creditor positions since July 28, 1969. For FY 1960 and FY 1965, the amount represents quota minus holdings of a member's currency that are below quota.

2/ Excludes the valuation gain from adherence to IAS.

3/ This mainly represents the amount by which the net receipt of assets on the Fund's income and expense transactions has exceeded net income on an accrual basis.

4/ As valued in the balance sheet of the GRA.

APPENDIX IV

Table 7. Members' Quotas, Norms, and Potential Unremunerated Reserve Tranche

(In millions of SDRs, except as indicated)

Member	Quota 1/ (1)	Norm 1/ (2)	Potential Unremunerated Reserve Tranche: (1) - (2) 2/	Memo: Norm as percentage of Quota (4)
AFGHANISTAN, I.S. OF	120.4	111.2	9.3	92.3
ALBANIA	48.7	46.6	2.1	95.8
ALGERIA	1,254.7	1,222.2	32.5	97.4
ANGOLA	286.3	274.3	12.0	95.8
ANTIGUA AND BARBUDA	13.5	13.1	0.4	96.8
ARGENTINA	2,117.1	2,007.1	110.0	94.8
ARMENIA	92.0	88.3	3.7	96.0
AUSTRALIA	3,236.4	3,070.2	166.3	94.9
AUSTRIA	1,872.3	1,804.8	67.5	96.4
AZERBAIJAN	160.9	154.4	6.5	96.0
BAHAMAS, THE	130.3	125.3	5.0	96.2
BAHRAIN	135.0	132.5	2.5	98.1
BANGLADESH	533.3	502.1	31.2	94.1
BARBADOS	67.5	64.3	3.3	95.2
BELARUS	386.4	370.9	15.5	96.0
BELGIUM	4,605.2	4,442.7	162.5	96.5
BELIZE	18.8	17.9	0.9	95.4
BENIN	61.9	58.7	3.3	94.7
BHUTAN	6.3	6.1	0.2	96.7
BOLIVIA	171.5	162.3	9.3	94.6
BOSNIA & HERZEGOVINA	169.1	162.6	6.5	96.2
BOTSWANA	63.0	61.8	1.3	98.0
BRAZIL	3,036.1	2,926.1	110.0	96.4
BRUNEI DARUSSALAM	150.0	141.7	8.3	94.5
BULGARIA	640.2	614.6	25.6	96.0
BURKINA FASO	60.2	57.0	3.3	94.6
BURUNDI	77.0	72.3	4.8	93.8
CAMBODIA	87.5	81.3	6.3	92.9
CAMEROON	185.7	177.0	8.8	95.3
CANADA	6,369.2	6,094.2	275.0	95.7
CAPE VERDE	9.6	9.2	0.4	95.8
CENTRAL AFRICAN REP.	55.7	52.5	3.3	94.3
CHAD	56.0	52.8	3.3	94.2
CHILE	856.1	816.6	39.5	95.4

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(In millions of SDRs, except as indicated)

Member	Quota 1/ (1)	Norm 1/ (2)	Potential Unremunerated Reserve Tranche: (1) - (2) 2/	Memo: Norm as percentage of Quota (4)
CHINA	4,687.2	4,549.7	137.5	97.1
COLOMBIA	774.0	734.8	39.3	94.9
COMOROS	8.9	8.4	0.5	94.7
CONGO, DEM. REPUBLIC	291.0	262.8	28.3	90.3
REPUBLIC OF CONGO	84.6	81.4	3.3	96.2
COSTA RICA	164.1	156.1	8.0	95.1
COTE D'IVOIRE	325.2	312.2	13.0	96.0
CROATIA, REPUBLIC OF	365.1	349.9	15.2	95.8
CYPRUS	139.6	133.1	6.5	95.3
CZECH REPUBLIC	819.3	785.3	34.0	95.9
DENMARK	1,642.8	1,577.8	65.0	96.0
DJIBOUTI	15.9	15.2	0.7	95.5
DOMINICA	8.2	7.8	0.4	95.7
DOMINICAN REPUBLIC	218.9	208.2	10.8	95.1
ECUADOR	302.3	294.1	8.3	97.3
EGYPT	943.7	896.7	47.0	95.0
EL SALVADOR	171.3	162.6	8.8	94.9
EQUATORIAL GUINEA	32.6	30.6	2.0	93.9
ERITREA	15.9	15.3	0.6	96.0
ESTONIA	65.2	62.6	2.6	96.1
ETHIOPIA	133.7	127.0	6.7	95.0
FIJI	70.3	67.1	3.3	95.4
FINLAND	1,263.8	1,216.3	47.5	96.2
FRANCE	10,738.5	10,363.5	375.0	96.5
GABON	154.3	150.6	3.8	97.6
GAMBIA, THE	31.1	29.4	1.8	94.4
GEORGIA	150.3	144.2	6.1	95.9
GERMANY	13,008.2	12,608.2	400.0	96.9
GHANA	369.0	347.3	21.8	94.1
GREECE	823.0	788.5	34.5	95.8
GRENADA	11.7	11.2	0.5	95.7
GUATEMALA	210.2	201.2	9.0	95.7
GUINEA	107.1	101.1	6.0	94.4

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Table 7. Members' Quotas, Norms, and Potential Unremunerated Reserve Tranche

(In millions of SDRs, except as indicated)

Member	Quota 1/ (1)	Norm 1/ (2)	Potential Unremunerated Reserve Tranche: (1) - (2) 2/ (3)	Memo: Norm as percentage of Quota (4)
GUINEA-BISSAU	14.2	13.4	0.8	94.4
GUYANA	90.9	85.9	5.0	94.5
HAITI	60.7	56.0	4.8	92.2
HONDURAS	129.5	123.3	6.3	95.2
HUNGARY	1,038.4	993.1	45.3	95.6
ICELAND	117.6	111.9	5.8	95.1
INDIA	4,158.2	3,923.2	235.0	94.3
INDONESIA	2,079.3	2,014.3	65.0	96.9
IRAN, ISLAMIC REP OF	1,497.2	1,449.2	48.0	96.8
IRAQ	504.0	476.8	27.3	94.6
IRELAND	838.4	808.2	30.3	96.4
ISRAEL	928.2	895.7	32.5	96.5
ITALY	7,055.5	6,805.5	250.0	96.5
JAMAICA	273.5	260.3	13.3	95.2
JAPAN	13,312.8	13,012.8	300.0	97.7
JORDAN	170.5	164.8	5.8	96.6
KAZAKHSTAN	365.7	352.1	13.6	96.3
KENYA	271.4	259.4	12.0	95.6
KIRIBATI	5.6	5.4	0.2	96.3
KOREA	1,633.6	1,613.6	20.0	98.8
KUWAIT	1,381.1	1,364.9	16.3	98.8
KYRGYZ REPUBLIC	88.8	85.2	3.6	96.0
LAO PEOPLE'S DEM REP	39.1	35.9	3.3	91.7
LATVIA	126.8	121.8	5.0	96.0
LEBANON	203.0	200.8	2.3	98.9
LESOTHO	34.9	33.7	1.3	96.4
LIBERIA	71.3	64.1	7.3	89.8
LIBYA	1,123.7	1,117.7	6.0	99.5
LITHUANIA	144.2	138.5	5.7	96.0
LUXEMBOURG	279.1	274.1	5.0	98.2
FYR MACEDONIA	68.9	66.1	2.8	95.9
MADAGASCAR	122.2	115.7	6.5	94.7
MALAWI	69.4	65.7	3.8	94.7

Table 7. Members' Quotas, Norms, and Potential Unremunerated Reserve Tranche

(In millions of SDRs, except as indicated)

Member	Quota 1/ (1)	Norm 1/ (2)	Potential Unremunerated Reserve Tranche: (1) - (2) 2/ (3)	Memo: Norm as percentage of Quota (4)
MALAYSIA	1,486.6	1,440.1	46.5	96.9
MALDIVES	8.2	8.0	0.2	97.9
MALI	93.3	87.8	5.5	94.1
MALTA	102.0	98.0	4.0	96.1
MARSHALL ISLANDS	2.5	2.4	0.1	95.0
MAURITANIA	64.4	61.2	3.3	95.0
MAURITIUS	101.6	96.1	5.5	94.6
MEXICO	2,585.8	2,493.3	92.5	96.4
MICRONESIA	5.1	5.0	0.1	97.6
MOLDOVA	123.2	118.2	5.0	96.0
MONGOLIA	51.1	49.0	2.1	96.0
MOROCCO	588.2	560.0	28.3	95.2
MOZAMBIQUE	113.6	108.6	5.0	95.6
MYANMAR	258.4	243.4	15.0	94.2
NAMIBIA	136.5	130.7	5.8	95.8
NEPAL	71.3	68.2	3.1	95.7
NETHERLANDS	5,162.4	4,987.4	175.0	96.6
NEW ZEALAND	894.6	844.1	50.5	94.4
NICARAGUA	130.0	123.3	6.8	94.8
NIGER	65.8	62.6	3.3	95.1
NIGERIA	1,753.2	1,719.5	33.8	98.1
NORWAY	1,671.7	1,611.7	60.0	96.4
OMAN	194.0	192.3	1.8	99.1
PAKISTAN	1,033.7	975.0	58.8	94.3
PALAU	3.1	3.0	0.1	96.0
PANAMA	206.6	197.6	9.0	95.6
PAPUA NEW GUINEA	131.6	126.6	5.0	96.2
PARAGUAY	99.9	95.2	4.8	95.3
PERU	638.4	607.7	30.8	95.2
PHILIPPINES	879.9	841.2	38.8	95.6
POLAND	1,369.0	1,312.8	56.2	95.9
PORTUGAL	867.4	838.2	29.3	96.6
QATAR	263.8	258.8	5.0	98.1
ROMANIA	1,030.2	982.7	47.5	95.4

APPENDIX IV

Table 7. Members' Quotas, Norms, and Potential Unremunerated Reserve Tranche

(In millions of SDRs, except as indicated)

Member	Quota 1/ (1)	Norm 1/ (2)	Potential Unremunerated Reserve Tranche: (1) - (2) 2/ (1) - (2) 2/	Memo: Norm as percentage of Quota (4)
RUSSIAN FEDERATION	5,945.4	5,707.6	237.8	96.0
RWANDA	80.1	75.4	4.8	94.1
ST. KITTS AND NEVIS	8.9	8.5	0.4	95.8
ST. LUCIA	15.3	14.6	0.7	95.6
ST. VINCENT	8.3	8.0	0.3	96.2
SAMOA	11.6	11.1	0.5	95.7
SAN MARINO	17.0	16.5	0.5	96.8
SAO TOME & PRINCIPE	7.4	7.0	0.4	94.6
SAUDI ARABIA	6,985.5	6,952.0	33.5	99.5
SENEGAL	161.8	153.3	8.5	94.7
SEYCHELLES	8.8	8.6	0.3	97.2
SIERRA LEONE	103.7	97.5	6.3	94.0
SINGAPORE	862.5	853.3	9.3	98.9
SLOVAK REPUBLIC	357.5	342.7	14.8	95.9
SLOVENIA	231.7	223.3	8.4	96.4
SOLOMON ISLANDS	10.4	10.0	0.4	96.2
SOMALIA	44.2	39.5	4.8	89.3
SOUTH AFRICA	1,868.5	1,788.5	80.0	95.7
SPAIN	3,048.9	2,950.2	98.8	96.8
SRI LANKA	413.4	388.9	24.5	94.1
SUDAN	169.7	151.7	18.0	89.4
SURINAME	92.1	86.4	5.7	93.8
SWAZILAND	50.7	48.7	2.0	96.1
SWEDEN	2,395.5	2,314.3	81.3	96.6
SWITZERLAND	3,458.5	3,317.9	140.6	95.9
SYRIAN ARAB REPUBLIC	293.6	281.1	12.5	95.7
TAJIKISTAN	87.0	84.8	2.2	97.5
TANZANIA	198.9	188.4	10.5	94.7
THAILAND	1,081.9	1,048.4	33.5	96.9
TOGO	73.4	69.7	3.8	95.0
TONGA	6.9	6.6	0.3	95.7
TRINIDAD AND TOBAGO	335.6	319.9	15.8	95.3
TUNISIA	286.5	274.5	12.0	95.8

APPENDIX IV

Table 7. Members' Quotas, Norms, and Potential Unremunerated Reserve Tranche

(In millions of SDRs, except as indicated)

Member	Quota 1/ (1)	Norm 1/ (2)	Potential Unremunerated Reserve Tranche: (1) - (2) 2/	Memo: Norm as percentage of Quota (4)
TURKEY	964.0	926.3	37.8	96.1
TURKMENISTAN	75.2	72.6	2.6	96.5
UGANDA	180.5	170.5	10.0	94.5
UKRAINE	1,372.0	1,317.0	55.0	96.0
UNITED ARAB EMIRATES	611.7	608.0	3.8	99.4
UNITED KINGDOM	10,738.5	10,038.5	700.0	93.5
UNITED STATES	37,149.3	35,474.3	1,675.0	95.5
URUGUAY	306.5	289.3	17.3	94.4
UZBEKISTAN	275.6	264.6	11.0	96.0
VANUATU	17.0	16.2	0.8	95.1
VENEZUELA	2,659.1	2,576.6	82.5	96.9
VIETNAM	329.1	313.6	15.5	95.3
YEMEN	243.5	233.7	9.8	96.0
YUGOSLAVIA, FEDERAL REP.	467.7	448.8	18.9	96.0
ZAMBIA	489.1	470.1	19.0	96.1
ZIMBABWE	353.4	335.0	18.4	94.8
ALL MEMBERS	210,719.1	202,655.0	8,064.8	96.2

1/ As of December 31, 2000.

2/ For each member, the excess of quota over norm, expressed in SDRs, remains constant when quotas are increased, unless there is a decision to raise the norm under the provision of Article V, Sec. 9 (c).

Table 8. Rates of Charge and Remuneration, SDR and Market Interest Rates, and Grant Element, FY 1950-2000

(In percent per annum, except as indicated)

Financial Year	Rate of Charge on Ordinary Resources				Rate of Remuneration					Memo: Net Income (In millions of SDRs)
	Range (Basic Rate)1/	Average Rate		Rate of Charge on Borrowed Resources	Basic Rate	Adjusted for Burden Sharing	SDR Interest Rate 3/	Market Interest Rate 4/	Grant Element 5/	
		Basic Rate 2/	Adjusted for Burden Sharing							
1950	0.50-5.00	1.16	N/A	N/A	N/A	N/A	--	1.16	0.00	-1.6
1951	0.50-5.00	1.37	N/A	N/A	N/A	N/A	--	1.52	0.60	-1.9
1952	1.00-5.00	1.63	N/A	N/A	N/A	N/A	--	1.62	-0.04	-1.5
1953	1.00-5.00	1.96	N/A	N/A	N/A	N/A	--	2.18	0.86	-0.7
1954	1.00-5.00	2.15	N/A	N/A	N/A	N/A	--	1.01	-4.60	0.0
1955	2.00-5.00	2.15	N/A	N/A	N/A	N/A	--	1.62	-2.11	-2.5
1956	2.00-5.00	1.92	N/A	N/A	N/A	N/A	--	2.61	2.69	-3.7
1957	2.00-5.00	1.11	N/A	N/A	N/A	N/A	--	3.11	7.71	7.9
1958	2.00-5.00	1.76	N/A	N/A	N/A	N/A	--	1.13	-2.53	12.3
1959	2.00-5.00	2.25	N/A	N/A	N/A	N/A	--	2.96	2.74	20.5
1960	2.00-5.00	2.77	N/A	N/A	N/A	N/A	--	3.24	1.81	14.1
1961	2.00-5.00	2.67	N/A	N/A	N/A	N/A	--	2.33	-1.33	7.2
1962	2.00-5.00	1.78	N/A	N/A	N/A	N/A	--	2.74	3.73	25.0
1963	2.00-5.00	2.41	N/A	N/A	N/A	N/A	--	2.91	1.93	21.5
1964	2.00-5.00	3.03	N/A	N/A	N/A	N/A	--	3.52	1.87	23.2
1965	2.00-5.00	3.21	N/A	N/A	N/A	N/A	--	3.68	1.79	25.5
1966	2.00-5.00	2.29	N/A	N/A	N/A	N/A	--	4.19	7.15	44.5
1967	2.00-5.00	2.81	N/A	N/A	N/A	N/A	--	4.79	7.36	50.4
1968	2.00-5.00	3.05	N/A	N/A	N/A	6/	--	4.59	5.75	55.7
1969	2.00-5.00	3.16	N/A	N/A	N/A	6/	--	5.68	9.19	70.8
1970	2.00-5.00	3.31	N/A	N/A	1.50	6/	1.50	6.99	13.06	57.6
1971	2.00-5.00	3.67	N/A	N/A	1.50	6/	1.50	5.36	6.21	46.4
1972	2.00-5.00	3.84	N/A	N/A	1.50	N/A	1.50	4.23	1.47	-13.3
1973	2.00-5.00	2.98	N/A	N/A	1.50	N/A	1.50	4.83	6.87	-21.7
1974	2.00-5.00	2.85	N/A	N/A	1.50	N/A	1.50	7.68	16.89	-37.2
1975	2.00-6.00	3.19	N/A	6.88	3.09	N/A	4.42	8.83	19.27	-9.7
1976	4.00-6.00	3.90	N/A	7.18	3.60	N/A	3.90	6.44	9.12	-2.9
1977	4.00-6.00	4.26	N/A	7.34	3.83	N/A	3.83	6.50	8.03	-18.2
1978	4.00-6.375	4.77	N/A	7.38	3.56	N/A	3.56	5.94	4.24	27.5
1979	4.375-6.375	5.04	N/A	7.46	4.39	N/A	4.59	6.91	6.65	46.1
1980	4.375-6.375	5.25	N/A	7.81	7.08	N/A	7.87	10.90	18.51	3.1
1981	4.375-6.375	5.30	N/A	9.50	8.50	N/A	9.45	11.80	20.91	80.1
1982	6.25	6.25	N/A	12.98	11.08	N/A	13.03	13.03	21.29	92.0
1983	6.60	6.60	N/A	11.65	8.58	N/A	10.09	10.09	11.62	65.4
1984	6.60	6.60	N/A	11.28	7.39	N/A	8.69	8.69	7.16	73.1

Table 8. Rates of Charge and Remuneration, SDR and Market Interest Rates, and Grant Element, FY 1950-2000

(In percent per annum, except as indicated)

Financial Year	Rate of Charge on Ordinary Resources			Rate of Charge on Borrowed Resources	Rate of Remuneration		SDR Interest Rate 3/	Market Interest Rate 4/	Grant Element 5/	Memo: Net Income (In millions of SDRs)
	Range (Basic Rate)1/	Average Rate			Basic Rate	Adjusted for Burden Sharing				
		Basic Rate 2/	Adjusted for Burden Sharing							
1985	7.00	7.00	N/A	11.42	7.78	N/A	8.77	8.77	6.05	-29.9
1986	7.00	7.00	N/A	9.23	6.84	N/A	7.40	7.40	1.41	78.1
1987	5.80-6.15	5.89	6.38	7.30	5.89	5.34	6.01	6.01	0.43	86.1
1988	5.28-5.63	5.37	6.00	7.65	5.74	5.12	5.74	5.74	1.35	49.1
1989	5.50-7.38	6.43	7.38	7.90	7.05	6.15	7.05	7.05	2.20	54.2
1990	7.44-8.78	8.34	9.34	8.35	8.66	7.72	8.66	8.66	1.78	85.5
1991	6.80-8.06	7.65	8.92	9.18	8.79	7.18	8.79	8.79	3.90	69.8
1992	6.24-7.53	6.88	8.02	7.93	7.12	5.69	7.12	7.12	0.85	89.9
1993	5.02-6.35	5.65	6.00	6.59	5.71	4.57	5.71	5.77	0.22	70.6
1994	4.28-5.34	4.70	5.26	N/A	4.23	3.39	4.23	4.23	-1.77	73.5
1995	4.73-5.80	4.81	5.19	N/A	4.60	3.68	4.60	4.60	-0.78	85.1
1996	3.96-4.94	4.31	4.59	N/A	4.25	3.40	4.25	4.25	-0.23	89.3
1997	4.10-4.47	4.28	4.51	N/A	3.91	3.53	3.91	3.91	-1.40	83.4
1998	4.17-4.70	4.41	4.59	N/A	4.18	3.97	4.18	4.18	-0.87	163.8
1999	3.42-4.63	4.09	4.22	N/A	3.82	3.67	3.82	3.82	-1.52	435.6
2000	3.68-4.83	4.17	4.33	N/A	3.67	3.50	3.67	3.67	-1.90	268.3 7/

1/ Schedule of rates for FY 1950-81, and the range of quarterly (FY 1987-89) and weekly rates (FY 1990-92).

2/ The weighted average rate for FY 1950-81, and annual averages for FY 1987-92.

3/ The interest rate on the SDR, which was originally set at 1.5 percent, was increased in July 1974 to 5 percent for the 6-month period to December 1974. From January 1975 to July 1976, the SDR interest rate was determined in relation to the combined market rate and set in accordance with a formula. In July 1976, the SDR rate of interest was set at 60 percent of the combined market rate on short-term instruments in the five major money markets and in January 1979 was increased to 80 percent of the combined market rate. Since May 1981, the SDR rate has been equal to the combined market rate.

4/ The combined market rate on short-term instruments in the five major money markets as set out in Rule T-1(c) for 1975 onward; 3-month Treasury Bill rate before 1975.

5/ The grant element of outstanding Fund credit is calculated as the face value of outstanding credit of ordinary resources, less the discounted present value of future payments of charges (at the current rate of charge) and repurchases, taken as a percent of the face value. To discount future payment, the 3-month U.S. Treasury Bill rate has been used for the period 1950-74, and the combined market/SDR interest rate thereafter.

6/ The Fund made a preferential distribution of net income to members for FY 1968 and FY 1969 in amounts equal to 1.5 percent of the amounts by which 75 percent of a member's quota exceeded the Fund's average holdings of that member's currency during the year. Following the First Amendment of the *Articles* in 1969, remuneration was paid at 1.5 percent per annum. In addition, for FY 1970 and FY 1971, distributions of net income were made to raise the total remuneration to 2 percent.

7/ Excluding the cumulative effect of the adoption of International Accounting Standard No. 19 - Employee Benefits.

GLOSSARY

This glossary covers basic operational and financial terms used in the IMF (the Fund). (Words in light italics are "see also" references.)

Accounting Unit. The IMF's unit of account is the *special drawing right*, or *SDR*. Members' currencies are valued by the IMF in terms of the SDR on the basis of their *representative rates* of exchange, normally against the U.S. dollar at spot market rates if available.

Accounts and Departments. The IMF operates its financial functions through the *General Department*, the *SDR Department*, and the *Administered Accounts*, which are accounting entities and not organizational units.

Accounts of the Fund in Member Countries. The Fund's currency holdings are held in accounts of the Fund in designated *depositories* in member countries. These accounts are the No. 1 and No. 2 Accounts, and the Securities Account. The No. 1 Account is used for Fund transactions and operations, including *quota* subscription payments, *purchases*, *repurchases*, repayment of borrowing, and sales of the member's currency. All these transactions may also be carried out through the Securities Account, which may be established by the member to hold nonnegotiable, non-interest-bearing notes, or similar obligations, payable to the Fund on demand. These notes or similar obligations are issued by the member as a substitute for the currency holdings of the Fund. The No. 2 Account is used for the Fund's administrative expenditures and receipts in the member's currency and within its territory.

Administered Accounts. Accounts established for financial and technical services that are consistent with the purposes of the IMF, including the administration of resources contributed by individual members to provide assistance to other members. All *operations* and *transactions* involving the *Administered Accounts* are separate from those of the IMF's other accounts.

Amendments (to the Articles of Agreement). The *Articles of Agreement* have been amended three times: The First Amendment (July 1969) introduced the *special drawing right* (SDR). The Second Amendment (April 1978) reflected the change from the par value system based on a fixed price for gold to an international monetary system based on floating exchange rates. The Third Amendment (November 1992) allowed for the suspension of the voting and certain related rights of a member that fails to fulfill any of its obligations under the Articles (other than obligations with respect to SDRs). The Board of Governors in September 1997 adopted a resolution to amend the Articles to allow for a special one-time allocation of SDRs. The Fourth Amendment will become effective when three-fifths of membership having 85 percent of the total voting power have accepted it.

Articles of Agreement. An international treaty that sets out the purposes, principles, and financial structure of the IMF. The Articles, which entered into force in December 1945, were drafted by representatives of 45 nations at a conference held in Bretton Woods, New Hampshire. The Articles have been amended three times.

Basic Rate of Charge. A single unified rate of charge that is applied to the outstanding use of IMF credit financed from the IMF's *general resources*. The basic rate of charge, which is set as a proportion of the weekly *SDR interest rate*, is applied to the daily balance of all outstanding *purchases* (drawings) during each of the IMF's financial quarters. The basic rate is subject to a *surcharge*.

Burden Sharing. Decisions adopted by the Executive Board of the IMF since 1986 regarding the sharing, between members paying charges and members receiving *remuneration*, of the financial consequences to the IMF of overdue obligations. An amount equal to overdue charges (excluding special charges) and an allocation to the *Special Contingent Accounts* (currently only the SCA-1) are generated each quarter by an upward adjustment of the rate of charge and a downward adjustment of the rate of remuneration (see *Extended Burden Sharing*, *Special Charges*, *Remunerated Reserve Tranche*, and *Remuneration*).

Commitment Fee (Stand-By or Extended Arrangements, including amounts available under the Supplemental Reserve Facility and the CCL). A charge payable at the beginning of each period (usually one year) on the resources committed by the Fund for that period. This fee is refunded when committed resources are drawn.

Compensatory Financing Facility (CFF). A special IMF financing facility that provides resources to members to cover shortfalls in export earnings and services receipts, as well as excesses in cereal import costs, that are temporary and arise from events beyond the members' control.

Conditionality. Economic policies that members intend to follow as a condition for the use of IMF resources.

Contingent Credit Line (CCL). A facility similar to the *Supplemental Reserve Facility* (SRF) as a means of preventing the spread of an ongoing international financial crisis. The CCL enables members pursuing strong economic policies to obtain pre-approval of IMF financing.

Credit Tranche Policies. Policies under which members may make use of IMF credit. The amount of such use is related to a member's *quota*. Early in its history, the IMF made credit available in four tranches (segments), each equal to 25 percent of a member's quota. Provided a member is making reasonable efforts to solve its balance of payments problems, it can make use of IMF resources up to the limit of the first credit tranche on fairly liberal terms. Requests for use of more resources (upper credit tranche purchases) requires substantial grounds for expecting that the member's balance of payments difficulties will be resolved within a reasonable period of time.

Creditor (or Reserve) Position in the IMF. A member has a creditor (or reserve) position in the IMF if it has lent its currency to the IMF under a loan agreement, and/or the member has not purchased its *reserve tranche* with the IMF, and/or the IMF has used the holdings of the member's *quota* payment—to provide financial assistance to other members. More precisely, the creditor (or reserve) position is the sum of outstanding borrowing by the IMF from the member, if any, and the member's *reserve tranche position*.

Depository and Fiscal Agency. Each member designates a fiscal agency (ministry of finance, central bank, or similar entity) as a channel for the conduct of financial transactions with the IMF and a depository (central bank or similar agency) to maintain the *accounts of the Fund* (the IMF No. 1 and No. 2 Accounts and the Securities Account). Each depository is required to pay out of the Fund's holdings of the member's currency, on demand and without delay, sums to any payee named by the Fund. The depository also holds for safe custody on behalf of the Fund nonnegotiable, non-interest-bearing notes, or similar instruments, issued by the member in substitution for part of the Fund's currency holdings.

Designation Plan. A list of participants in the *SDR Department* whose balance of payments and reserve positions are sufficiently strong for them to be called upon to provide *freely usable currency* in exchange for SDRs within a financial quarter, together with the amounts they may be called upon to provide.

Early (or Advance) Repurchase. A repurchase (repayment) made under specific conditions, before the end of the established maximum repurchase period.

Early Repurchase Expectation. The expectation of repurchase (repayment) in advance of its originally scheduled due date. According to the *Articles of Agreement*, a member is normally expected to repurchase its currency (make repayment of usable currencies) as its balance of payments and reserve positions improve. Members are expected to make repurchases of outstanding purchases in the credit tranche, under the CFF and the EFF earlier than the schedule of repurchase obligations. An early repurchase expectation also applies to purchases made under the *Supplemental Reserve Facility and the Contingent Credit Lines*. Such repurchases are expected one year before they become due. At the request of the member, the IMF may decide to extend the expectation periods by up to one year, though not beyond the due date.

Emergency Assistance. Since 1962, the IMF has provided emergency assistance in the form of purchases to help members overcome balance of payments problems arising from sudden and unforeseeable natural disasters. This assistance was extended in September 1995 to cover certain postconflict situations. Assistance for postconflict situations, as well as for natural disasters, is normally limited to 25 percent of quota and is available only if the member intends to move within a relatively short time to an upper *credit tranche* arrangement.

Extended Arrangement. A decision of the IMF under the *Extended Fund Facility* that gives member the assurance of being able to *purchase* (draw) resources from the General Resources Account (GRA) in accordance with the terms of the decision during a specified period, usually three years, and up to a particular amount.

Extended Burden Sharing. The IMF established a second *Special Contingent Account* (SCA-2) on July 1, 1990, and decided to place SDR 1 billion to the account within about five years (through quarterly downward adjustments to the rate of *remuneration* and upward adjustments to the *basic rate of charge*). These actions were taken to safeguard against possible losses arising from undischarged repurchase obligations related to purchases financed by the encashment of "*rights*" following the successful completion of a *rights accumulation program*. The SCA-2 was terminated in 1999, and the balances in the account were refunded to the contributing members.

Extended Fund Facility. A financing facility under which the IMF supports economic programs that generally run for three years and are aimed at overcoming balance of payments difficulties resulting from macroeconomic and structural problems. Typically, an economic program states the general objectives for the three-year period and the specific policies for the first year; policies for subsequent years are spelled out in program reviews.

Financial Transactions Plan. The Executive Board adopts a financial transactions plan for each upcoming quarter specifying the amounts of SDRs and selected member currencies to be used in *purchases and repurchases* (transfers and receipts) expected to be conducted through the General Resources Account during that period.

First Credit Tranche Purchase. See *Credit Tranche Policies*.

Freely Usable Currency. A currency that the IMF has determined is widely used to make payments for international transactions and widely traded in the principal exchange markets. At present, the euro, Japanese yen, pound sterling, and U.S. dollar are classified as freely usable currencies.

General Arrangements to Borrow (GAB). Long-standing arrangements under which 11 industrial countries stand ready to lend to the IMF to finance *purchases* (drawings) that aim at forestalling or coping with a situation that could impair the international monetary system. The GAB currently amount to SDR 17 billion, and there is also an associated arrangement with Saudi Arabia for SDR 1.5 billion.

General Department. Comprises the General Resources Account (GRA), the Special Disbursement Account (SDA), and the Investment Account (not activated).

General Resources. Assets, whether *ordinary* (owned) or borrowed, maintained within the IMF's General Resources Account (GRA).

Holdings Rate. The exchange rate of the member's currency against the SDR at which the IMF holds the currency of the member. The holdings rate is based on market exchange rates (see *representative rate*).

Maintenance of Value. See *Valuation Adjustment*.

Net Cumulative Allocations. Cumulative allocations of SDRs less any SDR cancellations. (There have been no cancellations of SDRs.)

New Arrangements to Borrow (NAB). Arrangements under which 25 member countries or their financial institutions would lend to the IMF under circumstances similar to those covered by the *General Arrangements to Borrow (GAB)*. The total amount of the NAB is SDR 34 billion, and the combined amount that can be drawn under the NAB and the GAB also cannot exceed SDR 34 billion.

Norm for Remuneration. Calculated as the total of (1) 75 percent of a member's *quota* before the *Second Amendment of the Articles* (April 1, 1978), plus (2) any subsequent increases in *quota*. For a country that became a member after April 1, 1978, the norm is a percentage of its *quota* equal to the weighted average relative to *quota* of the norms applicable to all other members on the date that the member joined the IMF, plus the amounts of any increases in its *quota* afterwards. At each *quota* increase, a member's norm rises, becoming closer to 100 percent of its *quota*. A member's norm determines the *remunerated* and *unremunerated* portions of its *reserve tranche position*.

Operations. The use or receipt of monetary assets by the IMF, other than exchanges of monetary assets (that is, other than *transactions*). Examples are the payment of *remuneration* and receipt of charges. Operations in SDRs are uses of SDRs other than exchanges of SDRs for monetary assets.

Ordinary Resources. Assets held in the General Resources Account (GRA) that derive from members' *quota* subscription payments and the undistributed net income from the use of these resources.

Outright Purchase. A *purchase* (drawing) for which there is no IMF arrangement, such as a purchase under a special policy, e.g., the policy on the *emergency assistance*.

Periodic Charges. Charges (equivalent to interest), payable by a member on its outstanding use of IMF credit.

Poverty Reduction and Growth Facility (PRGF). Facility that provides assistance on concessional terms to low-income member countries facing protracted balance of payments problems.

Precautionary Balances. Balances held in the form of General and Special Reserves, and the two *Special Contingent Accounts* that were established in the context of the arrears strategy.

PRGF-HIPC Trust. The Trust for Special Operations for the Heavily Indebted Poor Countries (HIPC) and Interim PRGF Operations. The trust was established in February 1997 to channel special assistance to eligible heavily indebted poor countries and to subsidize PRGF loans.

Purchases and Repurchases. When the IMF makes its *general resources* available to a member, it does so by allowing the member to purchase SDRs or other members' currencies in exchange for its own (domestic) currency. The IMF's general resources are, by nature, revolving: purchases (or drawings) have to be reversed by repurchases (or repayments) in installments within the period specified for a particular policy or facility.

Quota. The capital subscription, expressed in SDRs, that each member must pay to the IMF on joining. Up to 25 percent is payable in SDRs or other acceptable reserve assets and the remainder in the member's own currency. Quotas, which reflect members' relative size in the world economy, are normally reviewed and possibly adjusted every five years.

Remunerated Reserve Tranche Position. A member receives *remuneration* from the IMF (at a rate determined by the IMF) on any excess of its *reserve tranche position* over the difference between its *quota* and its *norm for remuneration*.

Remuneration. The interest paid by the IMF on a member's *remunerated reserve tranche position*.

Representative Rate. The exchange rate of a member's currency, normally against the U.S. dollar, that is used in the IMF's *transactions* and *operations* with that member—that is, a currency (other than the U.S. dollar) is valued in accordance with the value of the U.S. dollar in SDR terms and the representative rate of the other currency in terms of the U.S. dollar. If the member has an exchange market where a representative spot rate for the U.S. dollar (against the member's currency) can be readily ascertained, then that representative rate will be used. If such a market rate cannot be readily ascertained for the U.S. dollar but can be ascertained for another currency for which a representative market rate against the U.S. dollar exists, then that cross rate can be used. Otherwise, the IMF determines a rate for the currency that is appropriate.

Reserve Tranche Position. The extent to which the IMF's holdings of a member's currency (excluding holdings that reflect the member's use of IMF credit and holdings in the IMF No. 2 Account that do not exceed 1/10 of 1 percent of the member's quota) are less than the member's *quota*. The reserve tranche position is a part of the member's external reserves.

Rights Accumulation Program (RAP). An economic program agreed between the IMF and an eligible member in protracted arrears to the IMF that provides a framework for the member to establish a satisfactory track record of policy and payments performance, and permits the member to accumulate rights to future drawings of IMF resources following clearance of arrears to the IMF, up to the level of arrears outstanding at the beginning of the program.

"Rights" Approach. A special approach to address the situation of members that were in protracted arrears to the IMF at end-1989, on the basis of a *rights accumulation program*.

Service Charge. A fixed charge of 1/2 of 1 percent levied on each *purchase* (drawing) of IMF resources in the General Resources Account other than *reserve tranche* purchases, which carry no charges. The service charge is payable at the time of the transaction.

Special Charges (Additional Charges). Charges levied on a member's overdue repurchases and charges.

Special Contingent Accounts—First and Second. Accounts established to hold precautionary balances in order to strengthen the IMF's financial position in connection with members' overdue financial obligations.

Special Drawing Right (SDR). International reserve asset created by the IMF in 1969 as a supplement to existing reserve assets.

- **SDR Allocation.** Distribution of SDRs to members by decision of the IMF. A "general" allocation requires a finding by the IMF that there is a global need for additional liquidity.

- **SDR Assessment.** An assessment levied by the IMF, at the same rate for all participants in the SDR Department, on a participant's net cumulative SDR allocations, to cover the expenses of conducting the business of the *SDR Department*.

- **SDR Department.** This department, an accounting entity rather than an organizational unit of the IMF, records and administers all *transactions and operations* involving SDRs.

- **SDR Interest and Charges.** Interest is paid to each holder of SDRs. Charges are levied, at the same rate, on each participant's *net cumulative SDR allocations*. The SDR interest rate is determined weekly by reference to a combined market interest rate. Interest on SDR holdings is paid, and charges on net cumulative allocations are collected, on a quarterly basis, and are settled on the first day of the subsequent quarter.

- **SDR Valuation.** The currency value of the SDR is determined daily by the IMF by summing the values in U.S. dollars, based on market exchange rates, of a basket of major currencies. The SDR valuation basket is normally reviewed and adjusted every five years.

Stand-By Arrangement. A decision of the IMF by which a member is assured that it will be able to make *purchases* (drawings) from the General Resources Account (GRA) up to a specified amount and during a specified period of time, usually one to two years, provided that the member observes the terms set out in the supporting arrangement. Drawings under a stand-by arrangement are normally subject to *credit tranche policies*.

Supplemental Reserve Facility (SRF). A facility established in December 1997 to provide financial assistance to members experiencing exceptional balance of payments difficulties due to short-term financing needs resulting from a sudden and disruptive loss of market confidence reflected in pressure on the capital account and the members' reserves.

Surcharge to the Basic Rate of Charge. A surcharge of 100 basis points is added to the *basic rate of charge* on outstanding Fund credit in excess of 200 percent of quota, and the surcharge rises to 200 basis points on credit above 300 percent of quota. The surcharge does not apply to purchases under the CFF and the special policy on *emergency assistance*. Different surcharges apply to credits under the CCL and SRF.

Transactions. An exchange of monetary assets by the IMF for other monetary assets (for example, a *purchase* or a *repurchase*).

Unremunerated reserve tranche position. This refers to the *reserve tranche position* on which a member does *not* receive interest (remuneration). The original *Articles* made no provision for remuneration but the First Amendment of the *Articles* in 1969 required the fund to pay remuneration on reserve tranche positions in excess of 25 percent of quota. The Second Amendment of the *Articles* later required remuneration to be paid on reserve tranche positions in excess of 25 percent of the member's quota on April 1, 1978—that part of the quota that was paid in gold prior to the Second Amendment. For members joining the fund after that date, the Fund pays remuneration on their reserve tranche positions in excess of a percentage of quota equal to the average percentage applicable to existing members. These percentages fall over time as quotas are increased, and are equal to 100 percent less the *norm for remuneration*. As some members may draw down their reserve tranche positions to levels below the point at which they begin to earn remuneration, actual unremunerated reserve tranche positions are less than potential unremunerated reserve tranche positions by the amount of use within the unremunerated reserve tranche.

Upper Credit Tranches. See *Credit Tranche Policies*.

Use of IMF Resources (or IMF Credit). Includes use of IMF resources under the General Resources Account, and loans made to members of resources in the Special Disbursement Account or resources borrowed by the IMF as Trustee for the PRGF Trust. The use of IMF resources (or IMF credit) in the General Resources Account consists of *transactions* in which a member in need of balance of payments assistance uses its own currency to acquire from the IMF SDRs or the currency of a member in a strong balance of payments and reserve position. As a result of these transactions, the IMF's aggregate holdings of SDRs and currencies do not change, but the composition of those holdings

changes. The "strong" member whose currency is used to provide assistance gains a larger *reserve tranche position*, on which it will receive *remuneration* (to the extent that the IMF holdings of its currency are less than its *norm for remuneration*).

Valuation Adjustment. Each member has the obligation of maintaining the value in terms of the SDR of the balances of its currency held by the IMF. Whenever the holdings of a member's currency are revalued (for a "strong" member, typically when its currency is used in a *transaction or operation*; for all members, at the end of the IMF's financial year), a receivable (for the IMF) or a payable (by the IMF) is established for the amount of currency payable by or to the member.

ANNOTATED REFERENCES

Financial structure components: SDRs, gold, currencies, borrowing

"The Pattern of Use and Holdings of SDRs," EBS/93/104 (6/28/93). Discusses the historical pattern of use and holdings of SDRs, including those of the Fund (pp. 17-19). The paper notes the Fund's limited operational need for SDRs and the principle that SDRs, as a supplement to the reserves of member countries, should be held largely by them.

"The Cost of Financing the Fund and its Distribution – Review of Burden Sharing", EBS/94/28 (2/18/94). Discusses the various items in the Fund's income statements, and alternative ways of financing the Fund's expenses, classifying them according to those permitted under the Articles of Agreement and those requiring an amendment.

"Reforming the Financial Structure of the Fund – The Role of the Variable Uniform Norm," EBS/94/139 (7/1/94). Discusses the sources and uses of funds in the Fund's balance sheet, especially Attachment II.

"Reforming the Financing of the Fund's Operations," EBS/94/235 (12/6/94). Discusses the various components of the Fund's income statement (pp. 1-3). Also discusses various proposals to modify the existing mechanism, particularly those that might be implemented during a transition period in anticipation of an amendment of the Articles.

"Gold in the Fund," EBS/95/69 (4/21/95). Reviews the role of gold in the Fund before and after the second amendment of the Articles that came into effect on April 1, 1978. Discusses the Fund's policies on holding or selling gold, and the considerations relating to the Fund's continued holding of gold.

"The General Arrangements to Borrow – A Review," EBS/95/117 (7/14/95) gives the history of the GAB.

"Borrowing by the Fund – A Chronological Review," EBS/95/122 (7/25/95) discusses the Fund's experience with borrowing.

"New Arrangements to Borrow – Proposed Decisions," SM/96/307 (12/31/96). Summarizes the NAB's main features.

Polak, Jacques J., 1999, "Streamlining the Financial Structure of the International Monetary Fund," in *Essays in International Finance*, No. 216 (Princeton, NJ: International Finance Section, Department of Economics, Princeton University). *In the context of a proposal to run the operations of the Fund in the GRA without the currency veil, this paper proposes the merger of the General and SDR Departments of the Fund, thereby enhancing the transparency of the Fund's financial operations. The paper suggests a scheme under which the Fund would set annually a minimum creditor position in the merged system, paying*

interest at the SDR interest rate on positions above the minimum and charging interest at the same rate on the shortfall below this minimum.

"External Review of the Quota Formulas," EBAP/00/52 (5/1/00). Reports on the findings and recommendations of a panel of external experts tasked with reviewing the formulas, particularly their adequacy.

"Staff Commentary on the External Review of the Quota Formulas," EBAP/00/66 (6/7/00) gives the staff's views on quota formulas and indicates a work program that includes quantification and consideration of alternative quota formulas.

Interest-free resources

EBS/94/28, pp. 7-10, discusses the interest-free resources of the Fund, including the working of the norm for remuneration.

EBS/94/139, pp. 8-19, provides an analysis of the proposal for a uniform adjustable norm, including simulations and comparisons with the existing system.

"Cost of Fund Credit – Principles of Burden Sharing – Concessionality in Fund Operations and Related Matters: Background Material for the Seminar," EBS/92/108, Sup. 1 (6/15/92). Note 5 discusses the technical implementation of the proposal for a uniform adjustable norm.

Operational interest rates and exchange rates

"Cost of Fund Credit – Principles of Burden Sharing – Concessionality in Fund Operations and Related Matters," EBS/92/108, (6/15/92). Discusses the simplification of the Fund's schedule of charges, the factors that bear on the cost of Fund credit, and the issue of concessionality in the Fund's financial operations.

EBS/92/108, Sup. 1, Note 2 discusses the historical evolution of the rates of charge and remuneration.

"Review of Fund Facilities – Preliminary Considerations," EBS/00/37 (3/2/00). Discusses a proposal to introduce a surcharge to the rate of charge (pp. 53-54).

"Review of Fund Facilities – Further Considerations," EBS/00/131 (7/10/00). Discusses several techniques for a graduated surcharge to the rate of charge (pp. 19-27).

"Review of Fund Facilities – Further Considerations – Supplementary Information on Rates of Charge," EBS/00/131, Sup. 1 (7/18/00). Describes the historical evolution of the structure of the rates of charge, and summarizes the experience with rates of charge that graduated with the amount or maturity of credit extended.

"Review of the Method of Valuation of the SDR," SM/00/180 (7/24/00). Provides the basis for the latest quinquennial revision of the SDR basket.

"Review of Fund Facilities – Follow Up," EBS/00/187 (8/31/00). Discusses the problems associated with long and/or large use of Fund credit, and what instruments could be used to address such problems, including, in particular, early or advance repurchases and the introduction of a surcharge on the rate of charge.

"Review of Fund Facilities – Proposed Decisions and Implementation Guidelines," EBS/00/216 (11/3/00), and Sup. 1 (11/21/00). These papers give the final decisions on changes to the CCL, the emergency assistance and the CFF, time-based repurchase expectations, the surcharge on outstanding Fund credit, and the commitment fee.

Burden sharing and concessionality

"Factors Relating to Burden Sharing in the Fund," EBS/85/126 (5/14/85). Concludes that the concept of burden in sharing the costs of operating the Fund cannot easily be defined, but noted that "in view of the importance of members' subscriptions, a key to the distribution of burdens and benefits, and the costs that are associated with both, is a member's quota and its share in the total of Fund quotas."

"Burden Sharing – Voluntary Loans," EBS/90/49 (3/16/90). Illustrates a voluntary scheme under which a member not participating fully in the burden sharing mechanism could voluntarily contribute resources to an account administered by the Fund.

EBS/92/108 discusses problems in implementing the burden sharing mechanism (pp. 5-7).

EBS/92/108, Sup. 1, discusses the issue of concessionality in the Fund's rate of charge in Note 2. Note 4 discusses various proposals for quota-based burden sharing.

Precautionary balances

"Factors Bearing on the Adequacy of the Fund's Reserves," EBS/85/125 (5/14/85). Discusses the main purposes that reserves serve: to provide protection against the impairment of subscribed assets; to allow some flexibility in adjusting the Fund's policies on the rate of charge in the face of adverse developments in its income; to augment the Fund's liquidity and its cost-free resources; and to demonstrate to creditors and the public that the Fund is soundly managed.

EBS/92/108 discusses the considerations that bear on an appropriate level of precautionary balances (pp. 8-10).

"The Fund's Precautionary Balances and Factors Bearing on Their Adequacy," EBS/93/84 (6/2/93). Relates the appropriate level of precautionary balances to the size of credit to members in good standing as well as those in protracted arrears.

"The Fund's Precautionary Balances," EBS/94/53 (3/11/94). Compares the Fund's precautionary balances with those of other international financial organizations, and also deals with a number of other issues relating to the adequacy of the Fund's precautionary

balances, such as the Fund's evaluation of its risk exposure, or the undervaluation of its (gold) assets.

"An Early Termination of the Second Special Contingent Account (SCA-2) and the Future of the Rights Approach," EBS/99/155 (8/13/99). Discusses the rationale for the existence of SCA-2 and the adequacy of the Fund's precautionary balances in the absence of the SCA-2.

"Review of the Fund's Income Position, the Rate of Charge, Precautionary Balances, and Burden Sharing for FY 2000 and FY 2001," EBS/00/70 (4/7/00). Summarizes the Executive Board's most recent views on the Fund's policies on reserve accumulation (pp. 12-20).

Technical assistance

"Annual Report on Technical Assistance," SM/00/227 (10/5/00). Notes the significant potential to maintain and even increase external financing for part of the Fund's technical assistance to its members.

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