FOR AGENDA

EBS/83/251
Correction 1

CONFIDENTIAL

November 29, 1983

To: Members of the Executive Board

From: The Secretary

Subject: The Level and Growth of Fund Reserves and the Determination of Fund Charges

The following correction has been made in EBS/83/251 (11/25/83):

Page 15, line 5: for "level of reservezxxCs" read "level of reserves, is"

A corrected page is attached.

Att: (1)

time. Consequently, if the reserve target would be determined as a fixed percentage of the outstanding volume of purchases or borrowings (or to the SDR interest rate), the absolute amount of reserve accumulation could vary considerably with the ebb and flow of Fund activity. The present target, which is based on the existing level of reserves, is relatively stable but may also be regarded as a minimum target for the medium term. The considerations that were of significance in establishing the target continue to be relevant, in particular the need to strengthen the Fund's financial position over time without putting an undue burden on Fund debtors through a large increase in periodic charges. The target provides for some increase in the Fund's reserves while also permitting some flexibility in the rate of reserve accumulation. The present Rules provide for the possibility periodically to adjust the net income target, and in present circumstances a case might be made to raise the target. However, there may be considerable advantages in maintaining the present 3 percent target while permitting some upward flexibility in the actual rate of accumulation of reserves, e.g., by the addition to reserves of income in excess of target as has been decided by the Executive Board in the last two financial years. In contrast, if net income fell for any length of time below the target in present circumstances, steps would need to be considered to restore the reserve growth to the target level.

IV. Determination of the Rate of Periodic Charge

1. Present policy

Since FY 1982, the rate of charge levied on the use of the Fund's ordinary resources has been determined at the beginning of each financial year on the basis of (i) the projected income and expense of the Fund for the year and (ii) a target amount of net income which has been set in the Rules at equivalent to 3 percent of the Fund's reserves at the beginning of the financial year, unless the Executive Board determines another target amount. The income position is reviewed midway through the financial year, and if at that time the actual net income for the first six months, on an annual basis, is below the target amount of net income by an amount of 2 percent or more of the Fund's reserves at the beginning of the financial year, the Executive Board shall consider how to deal with the situation. If the Executive Board does not reach agreement on a different course of action to safeguard the Fund's financial position, the rate of charge is automatically adjusted as of November 1 so as to ensure that the target amount of net income for the year will be achieved. 1/

Since the adoption in 1981 of the present method of determining the rate of charge on the use of the Fund's ordinary resources, the rate of charge that was set at the beginning of a financial year has been maintained throughout the year. However, actual income for each

1/ Rule I-6(4), which specifies the manner of setting the Fund's charges, is reproduced in Appendix II.

year has diverged from the target amount, as shown in Table 4 below:

Table 4. Rate of Charge, Net Income Target, and Actual Net Income

Financial year	Rate of charge	Net Income Target	Net Income Actual	Percent increase
1982	6.25	--	92	10.9
1983	6.60	28	65	6.9
1984	6.60	30	52*	5.2*

*Projected; see "Review of the Fund's Income Position" (EBS/83/248, 11/21/83).

The Executive Directors have in the past considered various alternatives regarding the disposition of the amount of net income that was earned in excess of the target amount. Under the present system the Executive Board has endorsed the preferred course of the management to place each year the amounts in excess of the target income to the Fund's reserves. An alternative course of action would have been to use the excess income to raise the rate of remuneration or lower the rate of charge retroactively. However, there is no a priori formula to determine the appropriate distribution between an increase in the rate of remuneration and a reduction in the rate of charge, at least as long as the rate of charge remains below the rate of remuneration or the rate of remuneration remains below the SDR interest rate. 1/ Another alternative would be to use a previous year's "excess" income as part of the net income for the subsequent financial year, so that the rate of remuneration could be higher or the rate of charge lower than would otherwise be the case in that year. This procedure could imply that the Fund would plan deliberately for a net deficit (as distinguished from a deficit that arises because of unanticipated developments) which would seem generally undesirable and inconsistent with the standing of a well-managed financial institution. Finally, income in excess of target could be distributed in accordance with Article XII, Section 6(a) to all member countries in proportion to their quotas. It may be difficult to find a consensus for this approach in view of the difficulties in balancing the interests of creditor and debtor countries

1/ Under the Articles, the rate of remuneration cannot exceed the SDR interest rate. Furthermore, decisions by the Executive Board regarding changes in the rate of charge and the rate of remuneration require a majority of 70 percent of the total voting power, and these may be difficult to achieve when the interest of Fund creditors and Fund debtors would conflict.