NOT FOR PUBLIC USE

INTERNATIONAL MONETARY FUND

Secretary's Journal of Executive Board
Informal Session 83/2

3:45 p.m., December 21, 1983

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

Executive Directors	Alternate Executive Directors
	W. B. Tshishimbi
	L. E. J. M. Coene, Temporary
B. de Maulde	X. Blandin
A. Donoso	
R. D. Erb	
M. Finaish	T. Alhaimus
T. Hirao	T. Yamashita
J. E. Ismael	Jaafar A.
R. K. Joyce	L. Leonard
	C. Robalino
	G. Grosche
G. Lovato	
R. N. Malhotra	A. S. Jayawardena
Y. A. Nimatallah	J. E. Suraisry
J. J. Polak	
A. R. G. Prowse	
G. Salehkhou	O. Kabbaj
	E. I. M. Mtei
M. A. Senior	J. L. Feito
J. Tvedt	A. Lindå
N. Wicks	T. A. Clark
	Wang E.

A. Wright, Acting Secretary
R. S. Franklin, Assistant

Also Present

Asian Department: J.-P. C. Gollé. Exchange and Trade Relations Department: C. D. Finch, Director; D. K. Palmer, Associate Director; S. Mookerjee, Deputy Director. External Relations Department: H. O. Hartmann. Legal Department: G. P. Nicoletopoulos, Director; J. G. Evans, Jr., Deputy General Counsel; Ph. Lachman. Middle Eastern Department: F. Drees, S. H. Hitti. Research Department: R. R. Rhomberg, Deputy Director; N. M. Kaibni. Treasurer's Department: W. O. Habermeier, Counsellor and Treasurer; D. Williams, Deputy Treasurer; D. H. Brown, R. B. Hicks, B. E. Keuppens, J. T. McDonald, T. M. Tran, G. Wittich. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: S. R. Abiad, E. A. Ajayi, H. A. Arias, C. J. Batliwalla, S. E. Conrado, J. Delgadillo, L. K. Doe, K. A. Hansen, W. Moerke, J.-C. Obame, Y. Okubo, M. Z. M. Qureshi, D. I. S. Shaw, D. Templeman. Assistants to Executive Directors: E. M. Ainley, H. Alaoui-Abdallaoui, J. R. N. Almeida, J. Bulloch, M. Camara, M. B. Chatah, I. Fridriksson, G. Gomel, V. Govindarajan, N. U. Haque, C. M. Hull, A. K. Juusela, H. Kobayashi, M. J. Kooymans, G. W. K. Pickering, T. Ramtoolah, M. Rasyid, Shao Z., S. Sornyanyontr.

1. RATE OF REMUNERATION

The Executive Directors, meeting in informal session, considered a staff memorandum (requested at EBM/83/177, 12/19/83) setting out a number of methods for increasing the rate of remuneration (EBS/83/237, Sup. 1, 12/20/83).

The Chairman observed that the methods set out in the staff memorandum were based on the understanding reached at EBM/83/177 that there would be no change in the method of setting the rate of charge on the use of the Fund's ordinary resources and of fixing the target rate of growth of reserves, including the safeguards for the Fund's net income position that were embodied in Rule I-6(4).

Mr. Erb stated that he continued to have a preference for increasing the rate of remuneration to 100 percent of the interest rate on the SDR in one step on May 1, 1984. However, in light of the concerns of others about the consequences of a one-step increase, he could go along with a phased approach, provided that the rate of remuneration was made equal to 100 percent of the interest rate on the SDR by January 1, 1985. For example, he could accept a modest increase on January 1, 1984, further increases in May and November 1984, and a final increase by January 1, 1985.

Mr. Ismael recalled that Executive Directors had not come to any definite conclusions at EBM/83/177 about the appropriate rate of remuneration. He recognized that, to some extent, the rates of both remuneration and charge should reflect market rates; however, they should also reflect the cooperative nature of the Fund. A commitment to raising the rate of remuneration to 100 percent of the interest rate on the SDR over a three-year period was difficult for him to accept. Directors should instead consider an appropriate level for the rate of remuneration only for the forthcoming fiscal year, on the understanding that it would be reviewed again at some appropriate time during 1984.

He was disappointed that the staff had made no effort to analyze the implications of an increase in the rate of remuneration for the rate of charge, Mr. Ismael continued; without some assurances with respect to charges, he could not at present commit his chair to any new approach without going back to his authorities. In the interest of reaching an acceptable compromise before 1984, he was prepared to consider an increase in the rate of remuneration of up to 5 percentage points with effect from the beginning of May 1984, provided that charges remained at their present level. Even in considering such a proposal, however, he would have to reserve his judgment until the impact of such a change on the target for the increase in the Fund's reserves was made clear.

Mr. Malhotra considered the staff memorandum to be inadequate as a basis for discussion because it proceeded on the assumption that an increase in the rate of remuneration to 100 percent of the interest rate on the SDR was an agreed target, and that only the means of reaching that target were in question.

Several important issues not dealt with in the paper had been raised at EBM/83/177, Mr. Malhotra recalled. First, a number of Directors representing both borrowers and creditors had expressed the view that an appropriate degree of concessionality in Fund charges was desirable. Without agreement on how much concessionality was considered appropriate, it would be premature to consider the methods presented in the staff paper, all of which assumed that the rate of remuneration would rise to 100 percent under one timetable or another.

At EBM/83/177, he had requested an estimate of incremental increases in the Fund's administrative costs in future, Mr. Malhotra continued. According to his own calculations, administrative expenditures had risen on average by about 13-14 percent a year between 1971 and 1983; if that trend were to continue, he would expect an increase of about SDR 28-30 million in FY 1984/85. Given the target for an increase in the Fund's reserves, it was likely that an additional SDR 60 million would need to be covered in the next fiscal year. Since it was generally agreed that all members should contribute to the administration of the Fund, those increases had to be taken into account in determining the rate of remuneration unless, of course, some other means--such as separate contributions to meet administrative expenditures--were established so that the burden of expenditures could be fairly shared. Unless and until Directors reached an understanding about the appropriate degree of concessionality and about arrangements to share increments in administrative expenditures and in the provision of reserves, it would be difficult for him to form a judgment about the level at which the rate of remuneration should be set.

It should be noted that borrowers contributed additional amounts to meet administrative expenditures through front-end and special charges, which were quite high, Mr. Malhotra said. In 1983, those charges had amounted to about SDR 72 million, accounting for a large proportion of administrative expenditures in the current year. In an earlier discussion, Mr. de Maulde had referred to the policy of a cooperative bank under which all its expenses went into the lending rate. However, the Fund had responsibilities that went well beyond the business of lending; for example, great expense was involved in the exercise of surveillance and the conduct of Article IV consultations. Even if the Fund were not lending, he doubted whether Fund expenditures would decrease much, and certainly not by SDR 72 million. Given the wide responsibilities of the Fund, any arrangement that implied that the 40 or so borrowers in the Fund should be bearing the full impact of future increments in administrative expenditures and reserves would be clearly unfair.

He was not saying that there were no circumstances in which the rate of remuneration could be raised, or even lowered, Mr. Malhotra remarked. There were, however, a number of variables involved in any decision on that matter, including an accepted level of concessionality and increases in the administrative expenditures of the Fund. From a table prepared for him by the Treasurer, he understood that the level of concessionality during 1983 was between 7 percent and 9 percent, depending upon whether rates in the U.S. domestic market or in the Eurodeposit market were used.

If the rate of remuneration were increased to 87.5 percent of the interest rate on the SDR, the degree of concessionality would fall to 5.8 percent against U.S. market rates and to 8.9 percent against Eurodeposit rates. With a rate of remuneration set at 100 percent, the degree of concessionality could fall to 1.5 percent against rates in the U.S. domestic market. That relationship had to be taken into account in determining whether or not, or by how much, to increase the rate of remuneration from its present level.

The issue became even more important in considering the charges involved in a drawing consisting of a mix of ordinary and borrowed resources, which was becoming the norm for most borrowers, Mr. Malhotra concluded. With a mix, the levels of concessionality that he had mentioned would be cut in half. In the circumstances, until agreement was reached on the appropriate level of concessionality, he could not accept any target or time frame for increasing the rate of remuneration to 100 percent of the SDR interest rate. He asked his colleagues to consider seriously whether they wished only Fund borrowers to bear the burden of increments in administrative expenditures and reserves.

The Chairman replied that the staff paper had not been intended to reflect all the various positions of Executive Directors at EBM/83/177; rather, in the hope that a compromise could be reached, the staff had been asked to produce a technical paper that would stimulate further discussion.

Mr. Erb, taking up Mr. Malhotra's invitation to focus on the issue of concessionality, stated that, as a general principle, creditors should not earn a profit on their lending to the Fund, nor should they lose by lending to the Fund. At the current level of remuneration, creditors had to pay money to lend to the Fund. Furthermore, if there were to be any calculations leading to a discussion of an appropriate degree of concessionality, they should perhaps be based on the London interbank offered rate (LIBOR) plus various spreads.

The Treasurer responded that the calculation of the concessionality of the Fund's rate [illegible]f charge was a complicated matter. Even if one assumed a [illegible] conceptual solution to the problem, questions would arise about [illegible]s should be used in the calculations. Mr. Malhotra had quoted [illegible] based on interest rates in the international market and in the [illegible] markets of the five members whose currencies constituted the SDR b[illegible]. However, as indicated by Mr. Erb, the calculations could be based on the cost of alternative resources to a debtor in a weak position that had the choice of borrowing either from the Fund or in the Euromarket, where there would be spreads that would convey some notion of the relative riskiness of the investment.

Mr. Mtei asked whether Mr. Malhotra had been correct in suggesting that, once the 100 percent target for the rate of remuneration had been achieved, the brunt of any further increase in the Fund's administrative expenses would be borne only by borrowers.

The Treasurer replied that Mr. Mtei's question was difficult to answer because it was based on a number of imponderables. First, it was necessary to make an assumption about the likely increment of administrative expenses from the time at which the rate of remuneration was made equal to 100 percent of the interest rate on the SDR. At present, he was uncertain when that rate would be reached, or even if it would be reached at all. Second, it was impossible to know what the rate of increase in administrative expenses would be in a given period; any estimate would have to be based on other assumptions that could be disputed.

Moreover, the total volume of unremunerated positions in the Fund could not be forecast with any degree of assurance, the Treasurer went on. As he had explained in an earlier discussion, the unremunerated positions comprised three elements: the level of the Fund's reserves, the sale of gold by the Fund, and the use of unremunerated reserve tranche positions. While the Fund's reserves were fairly stable, and while the amount by which the remuneration expense was diminished as the Fund exchanged gold for currency could be established, it was impossible to forecast the use of unremunerated reserve tranche positions. Experience showed that such use fluctuated widely, and the staff's efforts to estimate it for the purpose of establishing the net income projections for the Fund a year in advance were often off by 50 percent in one direction or another. Finally, there was another, more fundamental, problem in answering Mr. Mtei's question. He was uncertain whether, as Treasurer of the Fund, he had any authority--without specific guidance from the Executive Board--to attribute one item of expense to one item of income, because that practice was not consistent with the accounting system of the Fund at present.

Mr. Malhotra said, in response to Mr. Erb's reference to spreads in the market, that whatever the quality of the borrower in the Fund over the years, there had never been a real default, because borrowing nations placed a special priority on repaying the Fund. In the circumstances, it was odd to talk of spreads--which represented a risk factor--with respect to members' relationships to the Fund.

The Chairman considered that, conceptually speaking, there were three ways of assessing the degree of concessionality in Fund charges. The first way was to see whether the rate of charge was less than what would be needed to finance the costs of the institution, namely, staffing, administration, and the building up of reserves. A degree of concessionality would exist so long as the rate of charge was less than what was needed to balance those three categories of expenditure.

A second concept of concessionality, which was somewhat more demanding, would be to take into account the cost to creditors of furnishing resources for the Fund's lending operations, the Chairman continued. A third, and even more demanding, concept of concessionality would be to compare the rate of charge to the rate that a borrower would have to pay under the best conditions on the market. His own preference was to avoid that third concept because market rates tended to include an element of profit, while the Fund, as a cooperative institution, by definition did not make profits. Whatever concept was used, the question that had been raised by Mr. Malhotra was whether or not an appropriate degree of concessionality would remain if the rate of remuneration were raised to 100 percent of the interest rate on the SDR. Some element of concessionality would exist under any of the three concepts; the issue was whether it was sufficient or appropriate.

Mr. Malhotra added that the element of concessionality in the figures that he had quoted earlier had been calculated on the basis of a 6.6 percent rate of charge, which did not include the special charges that had amounted to SDR 72 million in 1983. In practice, the rate of charge was arrived at after other income had been taken into consideration and therefore did not fully reflect the charges borne by debtors to the Fund.

The Treasurer, commenting further on the concepts of concessionality, recalled that, under the first concept mentioned by the Chairman, the rate of charge was set by taking into account the costs to the Fund in providing ordinary resources, which included both the costs of remuneration and the administrative expenses. Refinements could of course be made in two areas, both mentioned by Mr. Malhotra. First, instead of using the established rate of charge as a reference, it would be possible to use the cost of borrowing by a member from the Fund, which would include special service charges. The difference overall was small, but it did raise the cost to the member somewhat. The second refinement was more complex. In all the calculations made thus far, nothing had been said about the fact that the Fund divided its resources into two parts: ordinary resources derived from quotas, and borrowed resources. In practice, the Fund passed on the cost of borrowed funds plus a margin of 0.2 percent. Mr. Malhotra seemed to be saying that, in taking a view about the costs of borrowing from the Fund, all costs to the member--including the additional costs for borrowed resources and the margin--should be considered. Such a calculation could be made if Executive Directors so desired, although the figures would of course be different for each member.

The second approach to defining the element of concessionality in Fund charges employed as a comparator the costs that major members of the Fund would have to pay in their own domestic markets if they borrowed in order to finance their subscription to the Fund, the Treasurer continued. The third approach, which compared the cost of borrowing from the Fund with the cost of borrowing from the market, might be considered somewhat distorted, as mentioned by the Chairman, because market borrowing included a profit element. However, that method was the one used by the World Bank in calculating the element of concessionality in its charges.

In response to an inquiry by Mr. Ismael about whether information was available on the consequences for the rate of charge that would follow from an increase in the rate of remuneration to various levels, the Treasurer observed that the staff had done its best to provide that information in Table 5 of EBS/83/237 (11/2/83) dealing with the rate of remuneration and the Fund's income position. That table showed what the rate of charge would be for FY 1985 if the rate of remuneration were raised from 85 percent to 92.5 percent, 95 percent, 97 percent, or 100 percent from the beginning of that year. Under those increases in the rate of remuneration, the rate of charge had been estimated to range from 6.93 percent to 8.33 percent.

Mr. Joyce said that he was concerned about the direction that the discussion had taken. The focus appeared to have been very much on the question of concessionality, which was of obvious interest to any member that expected to be a borrower from the Fund. However, while the matter of concessionality might well be deserving of discussion in its own right, it had little to do with the issue at hand. Moreover, the question was not whether the rate of charge was more or less concessional but whether it was "appropriate." The test of the appropriateness of the rate of charge was based on a determination that it was neither more nor less than was necessary for the Fund to cover its costs while accumulating reserves at a rate that had been deemed desirable.

Directors could of course take the position that, for some period of time--and it had already been quite long--the rate of remuneration could be set somewhat lower than might be necessary to guarantee that the Fund would receive sufficient resources to continue its operations, Mr. Joyce commented. However, if the Fund over the longer term wanted to be able to cover its costs, accumulate reserves, and provide as much financing as it could on the best possible terms to all its members, the rate of remuneration would have to be set sufficiently high. The current debate should be focusing on whether the suggested rate of remuneration was too high or too low, or whether the Fund could afford to continue with a rate of remuneration that was less than 100 percent of the interest rate on the SDR for a short period or for a long period of time; the issue of concessionality did not bear directly on that decision.

Mr. Malhotra, referring to the use as a comparator of the rate of interest denominated in a particular currency, noted that such a rate might be higher or lower than the interest rate on the SDR, which the Fund had adopted as the unit of account for all its operations.

He had difficulty in understanding Mr. Joyce's argument that the element of concessionality was not part of the issue, Mr. Malhotra continued. In his own view, it could not be isolated from the decision-making process with regard to the rate of remuneration, but he would discuss the matter with Mr. Joyce bilaterally. Also important was the impact of additional administrative expenditures and the further creation of reserves. He doubted whether it was fair by any standard to assign the responsibility for covering those costs to a few borrowers from the Fund.

While he agreed with the Treasurer that certain assumptions or estimates were difficult to make, certain elements were quite clear, Mr. Malhotra went on. For example, it was evident that administrative expenditures would rise from year to year, even if judgments about the future rate of growth might vary. It was also true that a target for reserve growth already existed and that the method by which charges were computed was established. If those elements were taken into consideration and a reasonable view were adopted toward some sort of sharing of costs, Directors would necessarily come to the conclusion that it was not right to take 100 percent of the SDR interest rate as the target for the rate of remuneration unless some way of distributing the burden of costs were found.

The Chairman said that he would be concerned if the Fund were to adopt Mr. Malhotra's assumption that the level of administrative expenditures would rise by 14 percent a year. It was true that administrative expenditures had increased over a number of years, but those increases had been based on the need to meet a number of challenges--including the construction of a building--that would not necessarily be repeated. It was clear that there would be some incremental increase in administrative expenditures over time, and Mr. Malhotra had indicated his concern that those increases would be paid for entirely by Fund borrowers once the rate of remuneration reached a ceiling. There was nothing to warrant the notion that the present element of concessionality--which reflected the fact that the cost reduction that was derived from unremunerated positions at present happened to cover approximately the administrative expenditures--had to be perpetuated. The question that Directors should be considering was how to avoid too abrupt a movement in the rate of charge stemming from decisions on the rate of remuneration. He would again invite Directors to focus on the staff paper and make suggestions that might lead to a reconciliation of the different views expressed in the Executive Board.

Mr. Polak proposed setting up a model by which the remuneration coefficient--currently 85 percent--would be raised by 3 percent at the beginning of each of the next five fiscal years, thus bringing the rate of remuneration to 100 percent of the SDR interest rate by the time of the next quota exercise.

Mr. de Maulde said that he could accept such an approach with a refinement by which the period of adjustment, although fixed in principle, could be shortened if the SDR interest rate were to fall or could be lengthened if the SDR interest rate were to rise.

Mr. Wicks remarked that, while Mr. Polak's suggestion had the advantage of setting a definite schedule for reaching the target, the time period was rather long. His own preference was for a much shorter timetable, perhaps along the lines of that suggested earlier by Mr. Erb. At the same time, he could accept the mechanism proposed by Mr. de Maulde whereby the period could be lengthened somewhat if the SDR rate of interest were to increase or shortened if the SDR rate were to fall. He saw some advantage in a link to the rate of interest, which might encourage some countries to prevent a rise in the interest rate by bringing their budget deficits under control.

Mr. Joyce said that he could go along with Mr. Wicks's suggested scheme, which was symmetrical and allowed for a degree of flexibility. His only question concerned the time period in which it was proposed to bring the rate of remuneration to 100 percent of the SDR interest rate. At the outside, there should be some assurance that the target would be reached before the beginning of the next quota review, although his authorities might find that outside limit somewhat on the long side.

Mr. Tvedt stated that he too could go along with Mr. Wicks's proposal.

Mr. Grosche considered Mr. Wicks's proposal to be interesting; it provided a way of bringing the rate of remuneration to 100 percent of the SDR interest rate in a relatively fixed period of time.

Mr. Polak observed that the proposals of Mr. Wicks and Mr. de Maulde could be approached in two ways. The Fund could establish a relatively short period, which could be lengthened or shortened on the basis of what happened to the interest rate; or it could decide on a somewhat longer period--say, five years or the occasion of the next quota increase--and then shorten it only if the SDR interest rate were to fall. One version of the latter approach would be to increase the rate of remuneration on May 1 of each year by 3 percentage points or by an amount corresponding to the fall in interest rates over the preceding year, whichever was larger. Under such an approach, the overall period could be much shorter than five years if interest rates were to fall, say, as much as 1 percent.

Mr. de Maulde said that he would like to see a version of Mr. Wicks's scheme that would ensure no change in the nominal rate of charge. More particularly, he could accept Mr. Polak's suggestion of a 3 percent addition to the rate of remuneration at the beginning of each fiscal year with the proviso that the increase would be postponed or reduced to the extent necessary to prevent any increase in the nominal rate of charge.

Mr. Wicks observed that his own idea was quite different from that of Mr. de Maulde because it established a definite timetable for reaching a rate of remuneration equal to 100 percent of the SDR interest rate. Under Mr. de Maulde's latest approach, if interest rates increased or failed to fall, the 100 percent figure would never be reached.

Mr. Hirao recalled that, in the previous discussion, he had suggested a three-step increase in the rate of remuneration that would bring the rate of remuneration to the equivalent of 100 percent of the SDR interest rate by May 1, 1985. In the interest of compromise, he could go along with the staff's suggested alternative, which would lengthen the period somewhat; he was also interested in Mr. Wicks's latest suggestion.

Mr. Malhotra, noting that Directors seemed to be calling for a new staff paper showing a greater number of models, said that he would like to see calculations that would show what would happen to the element of concessionality in each of the various models that might be prepared. In that connection, he hoped that one of the models offered would show zero change in the rate of remuneration.

Mr. Finaish remarked that consideration might also be given to a system whereby it would be agreed in principle to bring the rate of remuneration to 100 percent of the SDR interest rate but to make the speed of progress toward that end subject to regular reviews by the Executive Board.

Following a further brief discussion, during which a number of variants were put forward, the Executive Directors agreed to return to the matter on Friday, December 23 when they would take up a further staff paper that would take account of ideas put forward in the current discussion.

ALAN WRIGHT
Acting Secretary