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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 94/19

10:00 a.m., March 9, 1994

Contents

Executive Board Attendance

M. Camdessus, Chairman
R. D. Erb, Deputy Managing Director

Executive Directors	Alternate Executive Directors
M. Al-Jasser	A. A. Al-Tuwaijri
M.-A. Autheman	M. Sirat
J. Bergo	
	J. Prader
H. Evans	
H. Fukui	
	L. E. N. Fernando
J. E. Ismael	K.-T. Hetrakul
D. Kaeser	
A. Kafka	J. C. Jaramillo
	A. V. Mozhin
G. Lanciotti	
K. Lissakers	
R. Marino	
A. Mirakhor	M. Dairi
	M. A. Hammoudi, Temporary
L. J. Mwananshiku	
G. A. Posthumus	O. Havrylyshyn
C. V. Santos	
S. Schoenberg	
A. S. Shaalan	Y. Y. Mohammed
D. E. Smee	
E. L. Waterman	
Zhang M.	Wei B.
A. G. Zoccali	A. F. Jiménez de Lucio

L. Van Houtven, Secretary and Counsellor
S. L. Yeager, Assistant

Also Present

African Department: E. L. Bornemann, Deputy Director; C. Enweze, T. T. Gibson, A. Jbili. European II Department: J. Odling-Smee, Director; E. Brau, Deputy Director; P. M. Nagy, B. B. Zavoico. External Relations Department: G. Hacche. Fiscal Affairs Department: J.-L. F. Schneider. Legal Department: R. H. Munzberg, Deputy General Counsel; P. De Boeck, J. M. Ogoola. Middle Eastern Department: P. Chabrier, Director; M. D. Knight, K. Nashashibi. Policy Development and Review Department: J. T. Boorman, Director; T. Leddy, Deputy Director; M. Allen, H. M. Flickenschild, A. Zanello. Secretary's Department: J. W. Lang, Deputy Director; G. Djeddaoui, R. S. Franklin, A. Leipold, A. Mountford, S. W. Tenney. Treasurer's Department: D. Williams, Treasurer; G. Wittich, Deputy Treasurer; J. E. Blalock, W. J. Byrne, J. C. Corr, G. M. Fitzpatrick, D. Gupta, B. E. Keuppens, A. F. Moustapha, M. A. Wattleworth, B. C. Yuen. Western Hemisphere Department: S. T. Beza, Counsellor and Director. Office of the Managing Director: J. G. Blanch, P. R. Narvekar, G. R. Saunders. Advisors to Executive Directors: J. M. Abbott, J. O. Aderibigbe, G. M. Blome, R. F. Cippa, S. K. Fayyad, T. K. Gaspard, J. Jamnik, M. F. Melhem, P. A. Merino, J.-C. Obame, A. Raza, J. W. van der Kaaij. Assistants to Executive Directors: R. N. A. Ally, D. A. Barr, A. Cathcart, D. Desruelle, G. El-Masry, S. S. Farid, R. Ferrillo, A. Galicia, C. Gaseltine, M. Giulimondi, G. H. Huisman, S. Ishida, T. Kanada, W. C. Keller, K. J. Langdon, G. J. Matthews, J. A. K. Munthali, S. Narube, S. del C. Olgiati, J. Pesola, R. K. W. Powell, S. Rouai, M. Ryan, V. Verjbitski, A. Viirg, R. Von Kleist, Wang X., J. B. Wire.

1. EXECUTIVE DIRECTOR

The Acting Chairman welcomed Mr. Dairi to the Board as Alternate Executive Director for the Islamic State of Afghanistan, Algeria, Ghana, the Islamic Republic of Iran, Morocco, Pakistan, and Tunisia.

2. ERITREA - MEMBERSHIP - REPORT OF COMMITTEE

The Executive Directors considered the report by the Chairman of the Committee on Membership for Eritrea recommending the approval of a draft Resolution on membership for submission to the Board of Governors for a vote without meeting (EBD/94/41, 3/7/94).

Mr. Zoccali said that the Committee on Membership for Eritrea had met on Thursday, January 27 to review the terms of membership for Eritrea. The Committee, in assessing the situation of Eritrea, had recognized that the available data was insufficient and likely to underestimate the current size of the economy. In addition, after considering the characteristics of the Eritrean economy in relation to those of existing members, Committee members had decidedly leaned toward an actual quota that fell within the "upper boundaries" of the possible estimates. The Committee had agreed, therefore, to recommend an initial quota of SDR 11.5 million, with 23.5 percent payable in SDRs or in currencies of other members acceptable to the Fund, within six months of the effective date of membership.

A communication had been sent to the Eritrean authorities immediately following the Committee meeting, Mr. Zoccali remarked. While the authorities considered that a larger quota might be warranted, the response received on March 2, 1994 had indicated their willingness to accept those terms.

On behalf of the Committee on Membership for Eritrea, he was pleased to present the Committee's report and a draft Resolution on membership, which had been circulated to the Board on March 7, 1994, Mr. Zoccali stated.

Mr. Mwananshiku remarked that he welcomed the opportunity for the Executive Board to consider the Report of the Committee on Membership for Eritrea. In doing so, he wished to thank the Directors who were on the Membership Committee for their sympathetic understanding of the unique position of Eritrea and their decision to recommend a reasonable initial quota. He also wished to express his appreciation to the Committee Chairman, Mr. Zoccali, for his skill and leadership in ensuring that the Committee reached a unanimous decision without a prolonged discussion. He also wanted to thank the staff for its support to the Committee.

As pointed out in the Committee's report, the Eritrean authorities had indicated their acceptance of the terms and conditions of accession to membership, including the recommended quota of SDR 11.5 million and the proposed timing of payment of the subscription, Mr. Mwananshiku commented.

They also expected that the current data shortcomings identified by the staff would be overcome with Fund assistance and that adequate and reliable data on GDP and foreign trade would be available in good time to facilitate the consideration of Eritrea's quota at the next general review.

The Eritrean authorities wished to express their appreciation to the management and the staff for their cooperation during the difficult pre-membership phase and for their keen interest in the growth of the Eritrean economy, Mr. Mwananshiku stated. They looked forward to becoming a cooperative member of the Fund's global community.

The Executive Board took the following decision:

1. The Board of Governors is requested to vote without meeting pursuant to Section 13 of the By-Laws of the Fund on the draft Resolution set forth in EBD/94/41 (3/7/94).

2. The Secretary is directed to send the report and draft Resolution on Membership for Eritrea set forth in EBD/94/41 to each member of the Fund by rapid means of communication on or before March 14, 1994.

3. To be valid, votes must be cast by Governors or Alternate Governors and must be received at the seat of the Fund before 6:00 p.m. Washington time on April 11, 1994. Votes received after that time will not be counted.

4. The effective date of the Resolution of the Board of Governors shall be the last day allowed for voting.

5. All votes cast pursuant to this decision shall be held in the custody of the Secretary until counted, and all proceedings with respect thereto shall be confidential until the Executive Board determines the result of the vote.

6. The Secretary is authorized to take such further action as he shall deem appropriate to carry out the purpose of this decision.

Decision No. 10608-(94/19), adopted
March 9, 1994

3. COST OF FINANCING THE FUND AND ITS DISTRIBUTION - REVIEW OF BURDEN SHARING

The Executive Directors considered a staff paper on the cost of financing the Fund and its distribution and related issues (EBS/94/28, 2/18/94).

Mr. Posthumus made the following statement:

I welcome the staff paper on the issue of the cost of financing the Fund and its distribution, including the review of burden sharing, and I hope that the Board will ask the staff to elaborate more extensively on the issue of the financial structure of the Fund and, in particular, on a few proposals to solve problems arising from the present way of distributing the costs of financing the Fund.

Several related issues are at stake. The main priority is that the Fund's financial structure allows for a degree of flexibility to generate sufficient income to cover reserve and other requirements regardless of prevailing circumstances. This also assumes a certain degree of fairness in the distribution of the costs involved among Fund members and not only between creditors and debtors.

The current financial arrangements do not seem to be sufficiently flexible, as evidenced by the present shortfall in creditor countries' contribution to the Special Contingent Account 2 (SCA-2) relative to the envisaged schedule. Moreover, the degree of flexibility deriving from the current structure will structurally diminish as the main part of the Fund's interest-free resources, the nonremunerated reserve tranche position of members, will decrease in relative importance when the size and/or the expenses of the Fund grow.

The staff's alternative financing arrangements that do not require an amendment of the Articles of Agreement unfortunately do not seem to be feasible options. The extension of the present system of burden sharing to the Administrative Budget and the net income target would reduce the present degree of flexibility, as the main constraint in this respect--the 80 percent floor of the rate of remuneration relative to the SDR interest rate--would be hit even earlier. The other options--a charge for operating administered accounts or for technical assistance--would not increase the flexibility of the present financing arrangements. The amount of additional income involved would probably be small in any event.

An option that does not need an amendment of the Articles and one the staff leaves unmentioned, is a reduction of the SDR interest rate. By reducing this rate--a decision that requires a 70 percent majority of the total voting power--the rate of remuneration could be set below its current level. If, at the same time, the rate of charge was not lowered, Fund income would increase. This system offers the required flexibility in generating income. The option could, however, reduce the attractiveness of the SDR as a reserve asset and lower the incentives for creditor countries to participate in the financing of Fund credits.

Of the staff's alternative financing arrangements that do require an amendment, I see problems with levying a quota-based charge on member countries. Such charges would have to be budgeted. This would completely change the nature of the financing of the Fund and affect its monetary character. The option of removing or significantly reducing the floor of the rate of remuneration in terms of the SDR interest rate will offer a degree of flexibility comparable to the option of reducing the SDR rate. It, too, could lower the incentive for creditor countries to participate in financing Fund credits, but would leave the SDR as a reserve instrument unimpaired.

Two years ago, I proposed to study another alternative, namely, equalizing and, if necessary, increasing the unremunerated reserve tranche and having all members maintain this level of nonremunerated position in the Fund. This option would simultaneously create the desired financial flexibility and distribute the share in the costs among all Fund members according to quota. It would not disturb the incentive for creditors to finance Fund credits since the rate of remuneration on the resources supplied to the Fund through the operational budget could be equal to the SDR interest rate. The staff rightly points out that in this scheme, it would be necessary to ensure that the nonremunerated positions remain available. Mr. Wright suggested introducing measures to prevent the drawing down of the unremunerated reserve tranche while, at the same time, providing members with the right of access to an equivalent amount of funds on the basis of the same conditionality as the reserve tranche that is currently available, but with interest payable at the rate of charge. Another problem that could arise is that a given relative size of the unremunerated reserve tranche would result in heavy fluctuations in the income of the Fund depending on the fluctuations in nominal interest rates. One way to solve this problem would be to return the resulting excess income relative to the target to the Fund's shareholders, based on their quotas. This, however, in my view requires careful study to guarantee that at all times the unremunerated reserve tranche serves only the purposes of financing the administrative costs of the institution and the costs of reserves.

The alternative of equalizing and, if necessary, increasing the unremunerated reserve tranche seems, in my view, the best way to meet the requirement for a new financing arrangement, but would require an amendment of the Articles. I would like to ask the staff to further elaborate on the modalities of this arrangement. In addition, the possibility of removing the floor of the rate of remuneration in terms of the SDR interest rate deserves further study by the staff, as does the option of reducing the SDR interest rate, which would not require an amendment of the Articles.

Mr. Marino and Mr. Zoccali made the following joint statement:

We welcome this important review and appreciate the staff's attempt to help us address the difficult issue of how to improve the distribution of the costs of operating the Fund among its members. The threefold increase since 1982 of administrative expenses and precautionary balances--items in excess of operational expenses--the 20 percent decline in creditors' relative contribution, and the uneven impact on individual members depending on their level of involvement in the Fund's operations and transactions has aggravated the perception that the present system of allocating costs is inequitable, unpredictable, and nontransparent. If we are to advance in our quest for greater equity in the financing of the Fund, we should move beyond the creditor-debtor distinction that underlies the proposed alternatives that, according to the staff, can be accommodated without amending the Articles. In fact, this tack even seems a step backward in relation to the preference expressed by most Directors during the July 1992 seminar on the cost of Fund credit (EB/Seminar/92/1, 7/8/92) "for the costs of burden-sharing to be borne in proportion to quotas."

The staff highlights in Table 3 of EBS/94/28 that the relative contribution of creditor and debtor members to the financing of administrative expenses and precautionary balances is approximately equal, and concludes that "the overall incidence of the cost of financing the Fund under present arrangements is not skewed, but neither is it transparent." The fact that the so-called debtors account for approximately 25 percent of Fund quotas and voting power, while currently paying 50 percent of the bill of running the institution, calls into question the apparent balance of the status quo. Instead, we share the view expressed on page 16 of the staff paper that it is reasonable and even necessary to derive a comprehensive and more permanent system that ensures that members of vastly different economic size and financing ability contribute in an equitable fashion to financing the cost of operating the Fund in order to preserve the consensus-based nature of decisions in this institution.

If equity is to be the guiding criterion for cost distribution, how should the term be interpreted? It could be argued, for example, that the costs should be covered in direct proportion to the benefits received. From this perspective, it might even be said that all services provided by the Fund, such as loans and technical assistance, should be costed and charged to the beneficiaries. The major problem with this apparently economically sound approach is that the benefits derived from operating the Fund are systemic in nature as its surveillance responsibility attests. Concluding that marginal pricing should be increasingly used to ration specific services provided to individual members is likely to be a counterproductive response, which at best fails to address the aforementioned shortcomings of the present system.

The Fund was established to provide the machinery for consultation and collaboration on international monetary problems. This cooperative endeavor aims at facilitating the expansion and balanced growth of international trade, and contributing to world prosperity by promoting exchange stability and providing balance of payments assistance in a manner that shortens the duration and lessens the degree of external disequilibria. Article I of the Fund's Articles leaves little doubt as to the systemic nature of the Fund's actions. Therefore, it seems appropriate to allocate institutional benefits and costs on the basis of that initial understanding. A quota-based system reflecting, inter alia, members' relative participation in world output, trade, and payments, remains in our view the best proxy for allocating systemic benefits and, by implication, the costs of running the institution. In view of the evolving nature of our institution and the size of future demands in excess of operational expenses, it is clear that the guiding principles for distributing costs should not be based on changing creditor-debtor positions but rather on quotas. As also noted, the temporary nature of the burden-sharing arrangements per se and the possibility of substantial changes in the size and distribution of the nonremunerated reserve tranches in the face of inelastic demands needs to be addressed to reverse the increasing fragmentation in the base of support for required administrative decisions.

As a first step toward a quota-based system, agreement on the definition of the costs to be allocated remains crucial. In this regard, we consider useful the staff's separation of the costs of operating the Fund into two broad categories, following Mr. Posthumus's line of thinking during our July 1992 seminar; namely, operational expenses, administrative expenses, and the financing of the Fund's precautionary balances--the net income target, payments to cover deferred charges, and contributions to the Special Contingent Accounts. If we all agree with this separation of costs, the next step would be to seek a common ground for distributing equitably the nonoperational element. This leads us to the particular proposals analyzed by the staff.

Possible changes within the framework of the present Articles of Agreement fail to capture existing realities. More specifically, the extension of burden-sharing to administrative expenses and net-income target, while aimed at introducing greater equity between debtors and creditors, disregards creditors' contributions through nonremunerated positions. Two other suggested changes seek to recover the costs of providing specific services. We consider that these should not be part of today's discussion, as their pricing cannot be made independently of the system that is in place for the financing of nonoperational expenses more generally. Our concerns regarding the phasing in of charges for technical assistance were already expressed during the recent discussion of this topic (EBM/94/10, 2/9/94).

Regarding the more far-reaching changes in financing arrangements that would involve amending the Articles, the most attractive in terms of equity, transparency, and operational simplicity is to equalize the norm for remuneration at 100 percent of members' quotas and then periodically reduce the norm in order to cover the cost of financing the Fund. Under this system, the marginal cost of covering the nonoperational costs of the Fund would be borne by the whole membership, leading to a transparent decision-making process. Conceptually, this approach offers clear advantages and warrants further detailed analysis of its mechanics by the staff.

The role of the Fund's gold holdings cannot be ignored in this discussion. Valued at market prices, these substantially exceed the outstanding use of Fund credit and certainly change the picture regarding the level of the Fund's precautionary balances. Moreover, it seems that the partial mobilization of gold holdings could also contribute to defraying the costs of operating the institution without jeopardizing its solvency. As the staff points out in footnote 1 of page 11, "if the Fund decided to sell gold and invest the profits in the Investment Account, the Fund would not only receive income from the investments but would reduce its remuneration expense accordingly by the capital value of the gold that was sold." This being the case, it is surprising that no additional attempt was made by the staff to expound on possible options for the partial mobilization of such holdings.

In sum, we hope that as a result of today's discussion a constructive consensus can be reached regarding the desirability of a more quota-based distribution system of nonoperational costs. Subsequently, our efforts could center on the equalization of the norm for remuneration proposal. Further work by the staff should also include the possibility of a partial mobilization of gold holdings to increase the level of interest-free resources.

Mr. Autheman made the following statement:

I commend the staff for this very clear paper on a subject for which clarity is not necessarily a fait accompli.

I would like, first, to explain how I understand the logic of the present system. I will then comment on the proposed alternative ways of financing the Fund's expenses.

By linking Table 1 and Table 2 of the staff paper, we can divide the Fund's expenses into three categories. The first is expenses related to fixed activity--namely, administrative expenses--which, as shown in Table 3, can be related to the opportunity costs of holding the nonremunerated reserve tranche, which is incurred by many members, most--but not all--of them creditors. Indeed, while the staff asserts that the implicit-revenue of the nonremunerated tranche cannot be attributed to specific categories of Fund expenditure, I would suggest that, because this permanent income of the Fund is independent from the *magnitude of its lending activity, it is not irrelevant to compare* it to fixed administrative expenses.

Let me make an additional comment on this point. The equivalent-revenue for the Fund of the existence of the non-remunerated tranche is dependent upon two factors: a volume effect, namely, the size of these tranches, and a price effect, namely, the level of the SDR interest rate. The first effect tends to be stable; the second fluctuates. In the recent past, this price effect has played a large new role as the fall in the SDR interest rate since 1990 has led to an increase of the basic rate of charge to a level above that of the SDR rate.

The second category is expenses related to past lending activity, or more specifically, to arrears. These expenses are meant to be temporary, even if, as the case of Sudan shows, there is a risk that they sometimes lead to a loss. Through the burden-sharing arrangement, they are divided approximately symmetrically between debtors and creditors but are not paid by those few countries--18--that are not part of the operational budget.

This agreement has been efficiently implemented: the level of reserves is no longer dramatically short of the identified risk, as it was when the Special Contingent Accounts were created. Consequently, the question arises whether we should maintain the present pressure on the rates of charge and remuneration, and keep the same "rapid" pace of accumulation of reserves, independent of the rhythm of disbursements.

The third category is expenses related to current lending activity--remuneration expenses, interest on borrowing net of interest on SDR holdings, and net income, namely, the target for general reserves. These are paid through the periodic charges. More than 90 percent of periodic charges pay only the variable cost of the lent funds, which means that the intermediation costs of the Fund remain low.

I would draw two conclusions from this categorization of expenses. First, the equity issue does not strike me as being particularly acute neither among creditors, nor between creditors and debtors. It is true that the norm of remuneration is not uniform among creditors and that the choice of countries to be included in the operational budget is costly for these countries, because of the burden sharing, while not being directly linked with quota. But, while understanding that some members would favor a different system in this regard, I would not consider the present system as completely faulty, in particular because it allows for a good liquidity position while providing for relatively small discrepancies on each aspect: norms vary from 90 percent to 99 percent, with a large concentration around the average of 94 percent; the floor of two thirds of quota would limit the discrepancy as regards the operational budget. In addition, I note that this description does not take into account the important concessional activity of the Fund that is directly financed by the membership with a specific distribution. Therefore, the "equity issue" among creditors, should certainly be taken with a grain of salt.

Second, as regards equity between debtors and creditors, I note that the bulk of the rate of charge covers the Fund's lending expenses. Marginally, a shortfall in the implicit-revenue obtained from the nonremunerated tranche, in conjunction with a low SDR rate, has to be compensated for by an increase in the rate of charge in proportion to a falling SDR rate. But, when the SDR rate is high enough, the Fund's lending becomes concessional, as it was during the 1980s.

The current situation is characterized by two negative factors: the low level of the nominal SDR rate and the low level of lending activity in conjunction with an increasing role played by the enhanced structural adjustment facility (ESAF). Such a situation is clearly worrisome, because in the event of a complete end to the Fund's lending activity, and given the present level of nominal SDR rate, the nonremunerated tranche would not suffice to finance fixed administrative costs at their present level. However, the present SDR rate is not considered as the relevant long-term reference by the staff and, consequently, we should not put too much emphasis on this hypothetical situation. In any event, if the Fund's lending was expected to decline permanently, administrative costs should be reduced over time.

Nevertheless, I would feel more comfortable if we had a better balance between our fixed expenses and permanent income. Incidentally, our interest-free resources follow a rising trend in conjunction with the development of precautionary balances as indicated in Table 2 of the staff paper. They already play a great role in the Fund's financing and will contribute to improve our implicit permanent income.

I have reservations about most of the staff's proposals on alternative ways of financing the Fund. First, as regards those that would not involve changing the Articles of Agreement, I do not support extending burden sharing to cover administrative expenses and the net income target for two reasons: one is contingent on the present situation, as we are already at the floor of creditors' remuneration; the other is more structural, since it could be argued that implicitly--through the opportunity cost of retaining the nonremunerated tranche--creditors already cover the administrative expenses. Second, charging for operating administered accounts seems of marginal financial interest and would imply great generosity on behalf of contributors. Third, the idea of charging for the Fund's technical assistance should be further considered, but in the context of a possible structural benefit to the allocation of technical assistance. A naive budgetary approach might have adverse consequences. More resources could lead to more expenses.

As to proposals involving a change in the Articles of Agreement, the idea of levying an annual assessment to cover fixed costs is clearly a nonstarter: first, I am not sure that having the UN General Assembly involved in the conduct of the Fund's activities would be of great help; second, I would be reluctant to support an idea whose practicalities would involve annual approval of members' contributions by parliaments. I also would not favor breaking the link between the rate of remuneration and the SDR interest rate: to move in this direction would make the difficulties of running the operational budget only more acute, and would make it more difficult to have it based on liquidity considerations. Furthermore, such an approach would mean that the creditors' position vis-à-vis the Fund would become reserves of lower quality. While the proposal on reforming the nonremunerated tranche is intellectually much more appealing, especially if we were to assume a permanently low SDR interest rate, this proposal might raise difficulties for many debtor countries, both when the new system was implemented, as most of them would have to make a significant repurchase so as to rebuild their nonremunerated tranche, and when each year the norm was changed--and therefore additional repurchases might be needed--to take into account SDR interest rate volatility and uncertainties regarding the lending activity of the Fund. I would welcome further staff studies on this proposal, in particular, under different assumptions regarding the nominal SDR rate.

In conclusion, I am skeptical of the practical possibilities of changing our present system, which is the fruit of a history of well-designed compromises. If the present situation of low nominal rates and low lending activity persists, we would nevertheless be ready to consider the matter further.

Mr. Mirakhor made the following statement:

We continue to approach the discussions of achieving an equitable burden sharing of the cost of financing the Fund with an open mind. In the past few years, the Fund had demonstrated its flexibility and preparedness to adapt its policies to the rapid changes in the world economy and to the pressing needs of its membership. In this quest, not enough attention was paid to the impact of new policies on the cost of operating the Fund. The result has been the emergence of a multitude of financial facilities, various surveillance procedures of member countries, and a set of rates of charge and remuneration that no longer reflect the interest rate as a policy instrument. Now that the Fund is more than ever universal, we believe that the time has come to take a fresh look at its own operations with the objective of simplifying, streamlining, and consolidating its activities. As a matter of priority, we think that early emphasis should be devoted to devising a comprehensive, transparent, and equitable new system of sharing the cost of conducting Fund operations with the participation of the entire membership. To do this, there is a growing recognition that there is ultimately a need to amend the Articles of Agreement. Although this process is time consuming, it should not, in our view, constitute by itself a reason for not reforming the current burden-sharing mechanism. We recommend, however, that if the option of amending the Articles is retained, the Board should also take the opportunity to review all potential amendments that could enhance the functioning of the Fund.

Before commenting on the various proposals to better distribute the cost of financing the Fund among all members, we would like to elaborate and seek staff comments on two issues.

The first is the status of operations of the special contingent account No. 2 (SCA-2). The recent staff paper on the rate of charge, the rate of remuneration, and burden-sharing adjustments for the quarter ended January 31, 1994 (EBS/94/30) shows that the accumulated balance in the SCA-2 amounts to SDR 609 million and that the cumulative shortfall arising from the floor to the rate of remuneration of 80 percent of the SDR interest rate amounts to SDR 239 million. Had this floor not been in effect, the accumulated balance in the SCA-2 would have been SDR 848 million, or SDR 152 million short of the target amount of SDR 1 billion to be accumulated in the SCA-2. On numerous occasions we raised the issue of the relative contributions made by debtors and creditors to the SCA-2 and we understand that the staff will issue shortly a paper for consideration by the Board. We see an urgent need for the Board to discuss this issue and to reach a decision for the following considerations: our understanding of paragraph 2 of the decision establishing the SCA-2 is that to achieve the target amount of SDR 1 billion, debtor countries will have to contribute SDR 250 million, and creditor countries will have to contribute SDR 750 million. At end-January 1994 the cumulative contribution of debtor countries to the SCA-2 amounted to SDR 212 million, about SDR 38 million less than their expected shared contribution of SDR 250 million to the funding of the SCA-2.

Since the amount of SDR 38 million could be achieved during the next two quarters, we would like to know what course of action the staff will recommend when debtors' contribution reaches SDR 250 million. Without prejudging any solutions the staff might propose, we believe that debtors' contribution to the SCA-2 should stop when their accumulated contribution reaches SDR 250 million. Only creditors will have to continue contributing in order to make up for their accumulated shortfall until their contribution reaches SDR 750 million, corresponding to three times that of debtors.

The second issue is the remuneration of member countries contribution to the SCA-1 and the SCA-2. During Executive Board Seminar 92/1 on July 1, 1992, this chair proposed to remunerate debtors' and creditors' contributions to the SCA-1 and the SCA-2 until the time these resources are actually used to cover losses on overdue obligations. This proposal was detailed in our statement, and the Chairman, in his concluding remarks, encouraged the staff to analyze this suggestion. We still believe that the remuneration of members' contributions to burden sharing could alleviate many of the shortcomings of the current mechanism and could also constitute an interim solution to the adoption of a comprehensive and more equitable burden sharing. We would like to know whether the staff has further reflected on this proposal.

As to the various proposals to reform the system of sharing the burden of the cost of financing the Fund, we consider that an equitable mechanism that reflects the cooperative nature of this institution should take into consideration the following principles: all members, debtors, creditors, and neutrally positioned should contribute to the system; the burden sharing should cover the operational and administrative expenses of the Fund, the net income target, and the contributions to the SCAs; the rate of charge should be equal to the rate of remuneration--these rates should be a function of the SDR interest rate, preferably an average in order to reduce short-term fluctuations; in view of the importance of the ESAF in providing concessional financing to the least developing countries, considerations could also be given to including contributions to the ESAF among the elements to be covered by the new burden sharing mechanism; the contribution of each member should be based on the member's quota in the Fund; and the temporary and refundable contributions to the burden sharing, namely, contributions to the SCA-1 and the SCA-2 should be remunerated;

This new system could, in our view, be accommodated by adopting the third proposal involving the amendment of the Articles, namely, the "uniform norm and nonremunerated positions" approach under which all members will be required to maintain an agreed level of nonremunerated positions in the Fund. As the contribution of each member will be financed out of its external reserves, it is important at this stage to have some preliminary indications about the amounts of nonremunerated positions to be maintained by member countries in the Fund.

In view of the continued difficult payment positions of many members, we propose that the nonremunerated positions be financed by a part of an SDR allocation. This proposal has the following advantages: it makes possible the implementation of a truly cooperative burden-sharing mechanism among all the membership; since the burden sharing and the SDR allocation are accounts within the Fund, this type of allocation simplifies and streamlines the operations of the new burden-sharing mechanism and eliminates any risk of overdue reconstitution of nonremunerated positions; it eliminates the loss of reserves and revenues generated by the constitution of nonremunerated positions in the Fund; and it will not have any inflationary impact. It eliminates the deflationary effect of the constitution of nonremunerated positions in the Fund, on the one hand, without adding to international liquidity, on the other.

Mr. Fukui made the following statement:

Under the current financing arrangement, one of the systemic issues is the fact that the cost of financing the Fund's operations is mainly, or to a great extent, borne by those members that make use of the Fund's resources--that is, debtor countries. I basically agree, therefore, that there might be some room for discussion on systematic change to avoid an increasing burden on the debtor countries. At the same time, in view of the possibility that the financing needs of the countries of the CFA franc area and the status of the former Soviet Union are expected to increase, it is necessary to strengthen the Fund's financial position against credit outstanding. In this context, the addition to reserves through the present system of adjusting the rate of charge will further increase the burden on members making use of the Fund's resources. It is understandable, therefore, that the number of countries that bear this burden of adding to the reserves should be expanded, because strengthening reserves is good for the financial shape of this institution and serves the interest of member countries in general.

Having said this, I think that the present system is based upon a long history and compromises. I am therefore somewhat reluctant to change the present system in view of its real practicality. Additionally, from the viewpoint of more equitable burden sharing, other contributions, such as those to the ESAF, should also be fully considered. But if we are to have any consensus on the systemic reform of financing, it is most appropriate to discuss equitable financing arrangements based on burden sharing in line with members' quotas. But how to do this is a difficult question and will, most likely involve amendment of the Articles. On this occasion I would like to make a brief comment on the suggested proposal.

There might be room for discussion on the idea of setting a common norm; this deserves more thorough analysis. It is, however, difficult from a practical standpoint to support the idea of reimbursing costs through use of the General Resources Account, as the UN General Assembly would become involved in the conduct of the Fund's activities as a consequence. The idea of breaking the link between the rate of remuneration and the SDR interest rate will not bring about any change to the context of burden sharing, which is now limited to creditors and debtors, nor will it lead to a solution to the fundamental problem of attaining equitable treatment among member countries.

I cannot support the idea of extending the present financing arrangement without amending the Articles, as this aims at solving issues only between borrowers and lenders, and will not seek broader equity based on quotas. However, regarding the addition to reserves in order to strengthen the Fund's financial position, there might be some room for discussion on extending the present burden sharing, including adjusting the rate of remuneration to the net income target in addition to adjusting charges to debtor countries.

As technical assistance plays an important role in the context of supporting the adjustment effort by developing countries, and the technical assistance extended by the Fund's account attends to the basic needs of recipient countries, I would like to keep it as it is now, free of charge.

On the idea of imposing some charge on Administered Accounts, I would note that for the Japan Administered Account for technical assistance, the Fund levies overhead costs at the rate of 13 percent. If there is an increase in the charge, it will simply mean a decrease in available funds. Therefore, I cannot support this idea. Additionally, according to the staff, the administration of the Administered Account, for instance, the Japanese Arrears Fund, is relatively labor intensive, and represents a relatively large cost. In this regard, I would be interested to hear the staff's estimate of the cost. Moreover, it is difficult to understand why this proposal fails to take into account how much income was saved, or lost income rescued, by the Japanese Arrears Fund, to the general benefit of this institution. This is not relevant to the systemic issue of today's discussion and, in the event, the total amount involved will be minor. Nonetheless, this proposal is discouraging to contributors and eventually will not pay off.

Mr. Al-Jasser made the following statement:

Let me start by recalling part of my statement during the seminar on burden sharing in July 1992:

> While some of the criticisms against the current system are valid, it should be recalled that the burden-sharing agreements are the result of highly complicated, contentious, and tedious compromise with which no one is truly happy, but every one can live with. Reopening this subject at this time can only lead to prolonged, divisive, and unproductive discussions.

This remains my view, especially as the current system is working relatively well. Moreover, I doubt that a less imperfect system can be agreed upon, even if such a system existed.

It is true that, at any point in time, some inequities may have occurred under the current system. However, as noted in Table 3 and emphasized by Mr. Autheman, the distribution of costs does not seem to be skewed against borrowing countries. In fact, and in contrast to the view of Mr. Marino and Mr. Zoccali, the costs to borrowing countries of running the Fund are probably much smaller than those presented in the table. Moreover, the cooperative nature of the current system has been most indispensable in smoothing the impact of inequities over time by taking into account the changing circumstances of creditors. For example, in the 1980s, Saudi Arabia contributed disproportionately large amounts. We did that gladly, because that is how the system is supposed to work. Contributions by creditors have a cyclical pattern owing to their ability to contribute at different points in time. This approach, as imperfect as it may be, has served the institution and the membership well. Tinkering with it could undermine the spirit of cooperation in a way that may damage irreparably the long-term prospects of financing the institution.

Taking the above-mentioned factors into consideration, the quota-based alternatives proposed in the staff paper are likely to be more inequitable. At first glance, a quota-based system for financing the Fund would appear to be broad based, comprehensive, and equitable. However, a closer look would quickly show the shortcomings of this option. While all countries share in the benefits of Fund membership, the amount of benefits derived from such membership and the amount of resources spent by the Fund vary greatly between countries with similar quotas. A program country surely uses many more resources for designing and negotiating a program, as well as for technical assistance, than a nonprogram country with similar quota. This variance in benefits does not only apply to users of Fund resources versus nonusers, but also between creditor countries. For example, creditor countries with substantial commercial ties and investments in borrowing countries are likely to derive relatively larger benefits from Fund involvement in these countries than members lacking these ties.

The two quota-based financing options presented in the staff paper suffer from further shortcomings. The first proposal, which calls for a quota-based assessment in the General Resources Account, would not only need approval by parliaments in the various countries, but it could lead to the involvement of the UN General Assembly in the conduct of the Fund's activities. Again, I agree with Mr. Autheman and Mr. Posthumus that this "would completely change the nature of the financing of the Fund and affect its monetary character."

Alternatively, the proposed uniform norm and nonremunerated positions appear to resolve the issue of parliamentary approval and of the involvement of the UN General Assembly. However, it has its own operational impracticalities. First, all countries, including most of the heavily indebted and poorest members, that fully utilized their reserve tranche would have to replenish a substantial part of that tranche. Moreover, the expected year-to-year change in the nonremunerated position needed to finance the Fund in the future could create major difficulties.

As to the issue of instability in the rate of charge, it is not clear to me what the problem is. Actually, the use of the term "instability" is surprising, because the issue is variability, which is the natural state of any price such as the rate of charge. I hope that we are not questioning the variability of the rate of charge. Moreover, looking at Table 1, the basic rate of charge has varied much less than the variation in the SDR rate. Even with the inclusion of burden sharing, the variation remains smaller than that of the SDR rate. Indeed, this is one of the advantages of the current system. The substantial revenue that accrues to the Fund from interest receipts on the nonremunerated position of creditors helps in this smoothing. As the SDR interest rate increases, the revenue accruing to the Fund from this source also increases, thus limiting the burden of higher interest rates on borrowers. The opposite is also true. Here, it is important to remember that the basic rate of charge is highly concessional, even though in 1994 it is going to be somewhat higher than the SDR rate. Many members borrowing from the Fund would have serious difficulties borrowing from the market, and those that could borrow would certainly have to pay a substantial premium. Of course, the poorest countries will continue to be provided with highly concessional funding under the ESAF.

As to the suggestions in the staff paper regarding extending burden sharing, I strongly caution against any changes in the floor for remuneration. I also caution against extension of burden sharing to cover administrative expenses and the net income target, as this will likely weaken the reserve position of the Fund by reducing transfers to the SCA-2. Moreover, burden-sharing arrangements are temporary, while administrative costs are permanent. It is not clear to me that the former could be used to finance the latter from a legal point of view. Staff comment on this issue may be in order.

In conclusion, while some inequities may be present in the current system of financing the Fund, I do not think that a change at this time will be productive or will likely lead to a more equitable distribution. Of course, we need to continue our efforts to provide our services as efficiently as possible. Any improvement in the Fund's efficiency would benefit the membership at large. In this connection, continued efforts to consolidate expenditures as well as reduce--and, it is hoped, eliminate--overdue obligations are important steps. Moreover, as I noted during the discussion on technical assistance, we should consider asking the recipient country to bear at least the local and perhaps some other costs, such as travel, of technical assistance missions. This will not only defray some Fund expenses, but will also ensure a better utilization of our technical assistance.

Mr. Schoenberg made the following statement:

The staff has produced a well-written, well-focused, and, at the same time, even for laymen, comprehensible paper about cost distribution and burden sharing, which is certainly no easy task and which deserves our commendation. I was satisfied to read the basic conclusion, namely, that the current system of distributing the cost of financing the Fund is on the whole not skewed, although it leaves something to be desired in terms of transparency. We share that assessment, largely for reasons similar to those outlined by Mr. Fukui. Therefore, there seems to be no urgent need for fundamental changes at the present time.

That does not mean that I consider the current arrangements to be ideal. This chair has repeatedly criticized, for example, that the size of the remunerated reserve tranche is not a good criterion for the calculation of creditors' burden-sharing contributions, because this method puts those creditor countries at a disadvantage that overproportionally contribute to the Fund's financing. Nevertheless, in spite of such weaknesses, it could be argued that it might be counterproductive to seek fundamental changes in otherwise proven procedures in the prospect of eventually achieving only minor improvements in burden sharing.

I also see little need for an extension of the burden-sharing arrangement to cover administrative expenses. As these expenses are to a large extent directly or indirectly linked to the Fund's financial assistance to members, it is justified that the users of Fund resources bear the bulk of these costs. Mr. Al-Jasser has made a similar point. In this context, I would also point out that the Fund's rate of charge is still much more favorable than market-related interest rates. One should also take into account that the Fund often provides only a relatively small proportion of the required resources, with the catalytic role of its financial assistance being often much more important than its actual financial involvement. A somewhat lower rate of charge would thus not alleviate very much the total interest burden of debtor countries. Therefore, I do not concur with the view that the rate of charge may be too high and that this may discourage members from adopting appropriate adjustment policies. Such policies are above all in the interest of the member countries themselves, and I find it difficult to imagine that a responsible government would abstain from an arrangement with the Fund because it regards the present rate of charge as inadequate.

When considering possible reforms of the current system, we should avoid any changes that might further weaken the monetary character of the Fund. It may be difficult to maintain this monetary character and, at the same time, establish a new cost-distribution system that all members regard as "fair" and "equitable." In addition, the staff rightly points out that it is difficult to define "equity" and that there is no single key that would be generally acceptable. Let me mention, in this context, what would not be acceptable to us. We think that the reserve character of the reserve tranche and of SDR holdings, which form part of a country's liquid interest-bearing currency reserves, should not be weakened by a reduction of the remuneration or by the establishment of a new SDR interest rate that would not adequately reflect the opportunity costs of holding such reserves. Negative consequences for the readiness of creditor countries to contribute to Fund financing cannot be ruled out if Fund-related reserve holdings would become a "second-rate" currency reserve.

We should also exercise restraint concerning proposals that require an amendment of the Articles of Agreement. Although I would not, in principle, rule out such an approach, it would only be expedient to pursue this route further if there was at the same time a case for an amendment for other important reasons, so that various changes could be considered together. In that event, we could examine more thoroughly the proposal outlined by Mr. Posthumus, which aims at introducing a uniform norm and a uniform unremunerated portion of the reserve tranche for all member countries. I tend to agree with Mr. Autheman and other Directors that this approach has a certain intellectual appeal. I would like to emphasize, however, that it may not be easy to find acceptable ways to ensure that such nonremunerated tranches remain permanently available. I would also like to point out that this method could be applied only to the financing of administrative costs and the costs associated with overdue obligations.

We would not favor the proposal to finance the Fund by levying a charge payable in SDRs on the basis of members' quotas. Annual budgetary contributions by member countries would, indeed, change the nature of the Fund. The staff also rightly points out that a number of members would need parliamentary approval for annual appropriations for international organizations, which, in turn, could cause at least delays regarding the payment of charges to the Fund. It also cannot be ruled out that some parliaments might try to put pressure on the Fund by withholding their contributions until certain conditions are met. This would put those member countries that fulfill their obligations vis-à-vis the Fund in a timely manner at a disadvantage. I thus would not rule out that a new system along the proposed lines could be even more unfair and unbalanced than the status quo.

I would like to support the proposals to levy charges for operating administered accounts and to widen the range of charges for the Fund's technical assistance. Such additional charges could relieve the strain on the Administrative Budget to a certain extent, although I am aware that the revenue potential in this area is limited.

Mr. Evans made the following statement:

The staff paper provides a good summary of the present arrangements for financing the Fund. It brings together a great deal of detail and presents it briefly.

I have to say that, coming to these financing issues for the first time, the complicated and opaque nature of the arrangements is striking. Moreover, what seems to be some unfairness in the incidence of the costs is likewise striking. It appears to be unfair among the group of debtors as a whole, unfair among the group of creditors, and--although this is difficult and more subjective to assess--some have argued that it is unfair between creditors and debtors.

Mr. Marino and Mr. Zoccali have referred to an assertion in the staff paper that the relative contributions of creditors and debtors, respectively, to the financing of the Fund are now "approximately equal." This assertion is, the staff claims, justified by Table 3, a table with which I have some difficulty. According to this table, the sum of the debtors' share and the creditors' share exceeds the items to be financed. Nor does the table give full credit to the fact that, in every year prior to this, the basic rate of charge was lower than the SDR interest rate and, consequently, borrowers benefited from the provision of credit at rates that were even more concessional than they are now.

I am content with the calculation of creditors' contributions in the table. These amount to somewhat more than three fourths of the costs to be financed. Borrowers are therefore contributing the other quarter. Far from being equal, it seems to me that the creditors are bearing a share of the total costs that is not dissimilar to the present quota share of creditors given by Mr. Marino and Mr. Zoccali. There seems therefore to be no argument for a further shift in the burden toward creditors. I would be grateful for the staff's reaction to my remarks on Table 3.

As to the proposals mentioned in the staff paper, the extension of burden sharing to cover administrative expenses and the net income target would, on its own, have the effect of transferring the burden from debtors to creditors. For the reasons that I have just set out, I see no case for doing so.

The proposal for charging for operating administrative accounts, in principle, seems an alternative worth pursuing. I would be grateful for staff comment on whether revenue from this source would be significant. My feeling is that this proposal should be pursued if it could generate a significant amount of income. Perhaps we could ask the budget committee to consider the proposal in greater detail.

The proposal to charge for technical assistance provided by the Fund was only discussed by the Board a month ago. The budget committee is now the proper place to pursue this issue. Let me only say that I agree with Mr. Peretz's statement last month on this subject.

As to those proposals requiring an amendment to the Articles, I would stress that, while all of us recognize the risks associated with initiating an amendment, I do not feel that we should at this stage rule out any alternative purely because it requires one. We should examine promising proposals as fairly as we can and only then decide whether to approach the Governors for an amendment.

I am not attracted to the proposal of reimbursing the costs of conducting the General Resources Account. As the staff paper points out, it would amount to imposing a direct quota levy on members. I do not need to elaborate, because I agree with the reasons given by Mr. Posthumus.

We would resist strongly any move toward the proposal to break the link between the rate of remuneration and the SDR interest rate. But I have to say, I would take issue with Mr. Posthumus's proposal that the SDR rate be set at a lower rate than under present arrangements.

The proposal to harmonize the remuneration norms is, as some previous speakers have recognized, conceptually attractive. It would distribute costs proportionally to quotas, but without raising the problems that a direct quota levy would. In the absence of any objective judgment or assessment of equity, it would distribute costs in a way that, I hope, all would find acceptable. When the proposal was originally made by Mr. Posthumus in advance of the Board's July 1992 seminar, this chair strongly supported it. Indeed, as Mr. Posthumus has reminded us, this chair went some way in developing the idea. I would like to renew our support for this idea once more and join others in urging staff to develop it, drawing on Mr. Wright's remarks, into a concrete proposal that could be implemented through an amendment to the Articles. Only when such a proposal is before us will we be able to judge, first, whether it would be truly equitable and, second, whether we wish to approach our Governors for an amendment to the Articles.

The staff would also need to address the issue of which costs should be covered through this approach. I would suggest that administrative costs and net reserves could be financed in this way. This would correct a major defect of the present system of financing whereby a marginal increase in the Fund's administrative costs feeds through to a higher rate of charge but does not affect the unadjusted rate of remuneration; in this way, debtors bear the burden of incremental administrative costs.

I am less certain whether the costs subject to the present burden-sharing arrangements should also be included. Their inclusion would remove one beneficial aspect of the present arrangements--namely, that borrowers pay a rate of charge that is somewhat higher than the SDR interest rate. Even so, the rate charged on Fund financing is substantially below those that countries could achieve on the market--where market access is an alternative. I would not wish to erode further the monetary nature of the Fund by increasing the concessionality associated with the use of Fund resources.

We have to recognize that an amendment to the Articles might, at the end of the day, prove undesirable. The proposals in the staff paper that do not require an amendment fall conspicuously short of providing a comprehensive and long-lasting resolution to the concerns expressed by Directors. Perhaps I could throw down a challenge to the staff: can it, drawing on its ingenuity, offer a suggestion that Directors would find acceptable? Is there, for example, any way that the unremunerated reserve tranches of members could be considerably reduced? If so, this chair might be able to look more favorably on including the administrative costs and additions to net income within the costs subject to burden sharing.

Mr. Marino said that even if, as Mr. Evans had argued, there was broad burden sharing between groups of debtors and creditors, the central issue was whether burden sharing should be based on a division of members into debtors and creditors or whether costs should be apportioned in line with shareholding. As he and Mr. Zoccali had argued, the latter approach would avoid the problem of inequities between groups of creditors or between groups of debtors. They therefore saw considerable scope for improving burden sharing, including through a more quota-based system.

Mr. Shaalan made the following statement:

The paper before us presents and analyzes various alternatives to the existing system of financing the Fund's expenses. Most, if not all, of these alternatives have been suggested in the past on grounds of equity or concern about the effect on the cost of Fund credit of having users of Fund resources bear too large a share of the cost of financing the Fund's operations.

Insofar as equity considerations are concerned, the existing system may be seen as functioning reasonably well in the aggregate as between debtors and creditors. In this regard, the staff notes that the burden of financing the Fund's administrative expenses and precautionary balances is spread approximately equally between the two groups. The existing system is not equitable, however, in the sense that not all Fund members contribute to financing the cost of Fund expenses and, perhaps more significant, in the sense that individual member contributions are not uniform in relation to what should form the basis of rights and obligations in a quota-based institution--namely, quotas.

Of the alternatives considered in the staff paper, those that could fundamentally address the equity issue fall in the category of suggestions identified by the staff as requiring amendments to the Articles. The time-consuming and complex nature of constitutional amendments is well recognized, although, in my view, this should not in itself be a sufficient reason not to pursue those suggestions further. It is important to keep in mind, however, that at least some of the suggestions in question would entail a reduction in the competitiveness of Fund assets in relation to other assets, which, at the margin, is bound to discourage members from participating in future augmentation of the capital base of the Fund through periodic increases in quotas. Therefore, like Mr. Al-Jasser, I do not see this as a viable option.

Some reduction in the cost of Fund credit could be realized within the framework of the present Articles. However, there is not much that can be expected to be achieved from pursuing the options outlined in the staff paper. For one thing, given the remuneration floor, there is no scope at present for extending burden-sharing arrangements to include financing administrative costs and the net income target. For another, the small contribution that might be realized by charges for operating administered accounts established at the request of members and broadening the existing system of charges for technical assistance could well be outweighed by the shortcomings of these options.

This said, the scope for achieving a reduction in the cost of Fund credit could be explored further. In this regard, consideration may be given to issues and options not discussed in the staff paper. Consideration could, for example, be given to the possibility of increasing the Fund's interest-free resources through the sale of gold. The rate at which the Fund accumulates reserves could also be reconsidered. Mr. Marino and Mr. Zoccali underscore the interrelatedness of these two options when they state that "valued at market prices the Fund's gold holdings substantially exceed the outstanding use of Fund credit and certainly change the picture regarding the level of the Fund's precautionary balances."

Ms. Lissakers made the following statement:

The information provided in the staff paper serves a number of useful purposes. First, it provides a reasonably good starting point for determining how the costs of Fund activities are shared among the membership and presents an interesting range of alternatives for discussion. Second, it makes clear the link between funding costs and administrative expenses--a factor that is frequently lost in the presentation of the budget, but which we hope to see remedied by new procedures. We need to remember that the "burden" is as important as the "burden sharing."

On the question of burden sharing, the staff paper lays out clearly the major issues and provides a helpful guide through a complicated financial arrangement. On one important topic, however, the issue appears to be somewhat misrepresented. Nonremunerated reserve tranches are treated in a way that tends to confuse the actual costs of Fund operations and distorts the calculations of relative contributions to the institution. Table 3, for example, illustrates how expenses are funded in the institution, but starts from a questionable premise--namely, that interest-free resources are treated as a free good in determining operational expenses. This results in a skewed picture of relative contributions.

In fact, it appears that charges would not cover operational expenses if the opportunity costs of nonremunerated reserve positions were included in those costs. This is suggested by the fact that the imputed costs of nonremunerated reserve tranche positions exceed those charges ascribed to nonoperational expenses. As a result, by not delineating more clearly the implicit interest subsidy received by borrowers, their contribution to nonoperational expenses is greatly exaggerated. It follows that the relative contributions, as presented in Table 3, are not nearly so close as is suggested. Moreover, the overall borrowing rates for borrowing countries are extremely favorable. Countries have access to medium- and long-term funds at short-term interest rates. And, there is no risk premium attached to the loans. Fund charges are already low by virtue of the risk-free, short-term rates that underlie the cost of funds--namely, rates on short-term government securities in the five currencies comprising the SDR--provided for Fund lending. Moreover, the charges reflecting these short-term rates are assessed on loans of medium- and long-term maturities.

Thus, the availability of interest-free quota resources in addition to the already low cost of funds allows for rates of charge that are highly concessional in relation to the market. The alternatives to Fund borrowing are instructive. World Bank interest rates are higher--7.27 percent compared with the Fund's adjusted rate of charge of 5.01 percent in the third quarter of 1994. Yield spreads for sovereign borrowers able to tap capital markets typically range between 100 basis points and 500 basis points above yields on industrial country bonds in the same currency and of comparable maturity.

One way to give a clearer picture of burden sharing would be to impute an SDR interest rate to the costs of interest-free resources in determinations of operational expenses. Charges would then be geared to meeting the true cost of funds as well as a share of administrative expenses and net income. This treatment would allow for a more straightforward means of judging relative contributions to nonoperational expenses, and arriving at possible means for allocating those costs. One might, for example, want to treat interest-free resources more as an endowment for subsidizing nonrevenue-generating activities than as a subsidy for already low borrowing charges.

This treatment is contained in one alternative mode of financing mentioned in the staff paper that has been floated previously and that seeks a common norm of remuneration below 100 percent and a requirement that all members maintain an agreed level of nonremunerated positions. We note both the arguments for and the questions raised about this proposal, and we share with other speakers the desire to see this idea explored further by the staff. It is certainly a proposal worth looking at in more detail.

I wish to make only a few comments on two other "equity" issues; one is the question of burden shifting, and the need to match current charges with risk.

Charges are currently higher than they otherwise would be under the current arrangements, because current borrowers are sharing in the costs of past borrowers' arrearages. This burden shifting is due to the fact that past charges did not reflect the true costs of borrowing--no provision was made for the probability of arrears emerging.

Incorporating risk assessments into charges involves some sensitive issues. The Fund is a preferred creditor, and potential repayment problems are best remedied through stronger program conditionality. Nevertheless, we know from experience that arrears do occur and will continue to occur. Some effort should be made to build in future arrearages problems into current charges. Such costs should be recognized in the charges of current borrowers, not future borrowers. Such treatment is fairer and consistent with fundamental principles of accrual accounting. Moreover, this approach need not compromise the uniformity of Fund treatment in assessing charges.

We need to take a more systemic, forward-looking approach to accumulating precautionary balances and seek to graduate from the backward-looking approach that now penalizes current borrowers as well as creditors for costs associated with past borrowings. Whatever the approach, we still believe strongly that precautionary balances need to be built up to allow for past and current arrears as well as potential future payments problems. I look forward to examining this issue in greater detail at the end of this month, during the discussion on precautionary balances.

The burden-shifting issue is germane to the concern expressed by some borrowers over the volatility of charges. Such volatility is in part due to the reactive approach to arrearages already mentioned.

The concern over volatility is somewhat selective, of course. It emerges when rates of charge or the coefficient linking the charge to the SDR rate is adjusted upward, but not when rates are declining or being maintained at lower than advisable levels. During the most recent midterm review of the Fund's income, for example, this Board missed an opportunity to smooth out the rate of charge over time by deciding against action to address the predicted shortfall in net income for this financial year. Instead of raising the coefficient of the rate of charge to address the shortfall, the problem was left for the next financial year and future borrowers. Adding coverage of this year's shortfall to next year's income target will entail higher charges and more volatility than would otherwise have been the case.

As to burden-sharing issues as they relate to creditors, I would first note our strong opposition to any lowering of the floor on the required rate of remuneration. As I noted earlier, creditors are already shouldering a disproportionate share of the nonoperational expenses in the institution. Further reductions in remuneration could raise questions about creditor support for the institution. Some creditors, for example, are currently realizing net losses on their reserve positions on a cash basis.

There are burden-sharing issues that exist among creditors as well as between creditors and "neutral countries"--namely, those who are neither borrowers nor lenders and have drawn their reserve positions. As the staff paper notes, nonremunerative positions vary among creditors, which means that some are providing a larger share of interest-free resources to the institution than others. In addition, some nonborrowing countries have drawn down their reserve positions and so provide no interest-free resources to the institution in addition to avoiding burden-sharing costs.

Both situations present clear equity issues in search of a remedy. The proposal to establish a common norm for remuneration is one way of addressing this issue, and another reason to look further into this idea.

As we noted at the discussion on technical assistance, we can support some move toward greater recipient country contributions to the expenses incurred by this service.

Mr. Marino and Mr. Zoccali have brought up the question of the use of the Fund's gold. We also are curious to hear what the staff might add on the question of whether some scope might exist for generating some additional income for the institution through the use of the Fund's gold in secure, short-term transactions, for example, swaps or collateralized transactions. It is at least an idea worth exploring.

Mr. Smee made the following statement:

The staff has provided a useful summary of the costs incurred in operating the Fund, the criticisms of the present operating arrangements, and alternate ways of covering the Fund's expenses.

The impact of declining interest rates on Fund costs was particularly striking. With the rate of remuneration fixed to be no lower than 80 percent of the SDR interest rate, the decline in interest rates has narrowed in absolute terms the spread earned on Fund operations. This is partly a timing problem that could be alleviated if the SDR interest rate increased over time and if there were a further reduction in the amount of overdue obligations to the Fund.

In the interim, efforts should be made to look at ways to reduce the burden borne by the membership. A good starting point would be to reduce administrative expenses, which have increased steadily in recent years. A key element to control is salary expenditures at all levels of the Fund, including Executive Directors and senior management.

As to the issues at hand, we do not think that the current financing system is grossly unfair. While the system is not perfect, it provides a reasonable basis to cover administrative and operational costs. Although the share financed by creditors has declined over time, there still seems to be relative balance, with creditors contributing about 53 percent and borrowers about 47 percent in financial year 1993.

It seems reasonable to expect that a significant portion of the burden of operating an international financial institution should fall on the main users, that is, the borrowers. At the same time, a core of creditors are in the best position, in view of their financial strength, to provide the resources for Fund lending to borrowers.

Where perceptions of inequity exist, such as the burden of building up precautionary balances under the SCA-2, relatively simple solutions can be incorporated in the funding mechanisms to provide better balance. The staff's suggestion of estimating likely creditor contributions to the SCA-2 and adjusting debtor contributions accordingly to achieve the desired three-to-one mix is practical and easily implemented. It may take longer to reach our objective of SDR 1 billion, but correcting perceptions of inequity does have its own consequences.

We are not unduly concerned about the "neutrally positioned" members. Our tally of these members shows two distinct groups: new members who have not as yet availed themselves of the General

Resources or who have gone directly into (ESAF) arrangements, and very small economies, some of which are in my constituency, whose fragile reserve positions generally preclude their being included in the operational budget, but whose relatively sound macroeconomic fundamentals mean that they do not need to have recourse to Fund resources.

In any case, we see little need to radically revamp the system to capture contributions by members who account for only 2.7 percent of total quota, particularly when it seems reasonable to assume that many neutrally positioned members could soon make use of Fund resources.

On the basis of more equity between debtors and creditors and among debtors and creditors, it would appear that little can be done to change funding arrangements--and increase revenues--without an amendment to the Articles of Agreement. There is little mileage to be gained from charging for the operation of administered accounts or widening the range and the level of charges for technical assistance. Neither option is likely to yield much, and both have their drawbacks.

With respect to the three options that would involve an amendment to the Articles, if, in fact, reform of the system is deemed necessary, our preference would be for the third option. Levying a charge on the basis of members' quotas is not at all attractive to us in view of the likely need for parliamentary approval of our annual appropriations, not to mention the fact that the Fund would be subject to a regular budgetary review by the United Nations. Another downside risk to this proposal, which is not mentioned by staff, is the possibility that these levies would not be paid, presenting the Fund with an arrears situation analogous to that of the United Nations.

Steps have already been taken in recent years to give greater weight to quotas in the operational budget, but there are clearly limits on the amount of resources the Fund can tap, since the ability to pay is better reflected in reserve positions.

We do not think that the link should be broken between the rate of remuneration and the SDR interest rate. Canada was instrumental in establishing a market-related return for creditors, and we would not like to see this progress diminished or reversed.

The issue of the floor to the rate of remuneration needs to be examined in terms of the likely evolution of the SDR interest rate. An increase in the SDR rate from its recent low level would ease the current restraint and provide the Fund with more scope on burden sharing. However, reducing or eliminating the floor would not bring the financing system closer to one that is more quota based.

Equalizing the norm for remuneration initially at 100 percent of quota and then periodically reducing the norm for all members by an amount to cover the cost of financing the Fund has been proposed by Mr. Posthumus. This appears to be the most promising of the alternatives presented, and it would be useful to have the staff explore this option in greater detail, including the implications for members and for the financing of the Fund.

The question that I would raise is: Is revamping of the system of financing the Fund really sufficiently important that we would like to open up the Articles of Agreement? Compared to the import of, say, the Second and Third Amendments to the fundamental operations of the Fund, I really do not think so.

A disadvantage of the third option, compared to the present financing arrangements, is that it might take pressure off management and the Board to limit increases in administrative expenses. Currently, if revenues are declining and it is increasingly difficult, or impossible, to raise the rate of charge or lower the rate of remuneration, the Fund must cut back elsewhere. Thus, the current system provides a strong and useful brake on the expansion of the Fund's operations. Any movement in the direction of the third option would have to be accompanied by clear guidelines on administrative expenses.

Mr. Fernando made the following statement:

The staff estimates have made clear that nonremunerated reserve tranche positions have contributed substantially, if only through imputation, to keep the rate of charge lower than it might have been in their absence. But, they are considered unstable and, in the staff's view, can change substantially over time. Mr. Autheman seems to imply that the imputed income from the nonremunerated tranche is more vulnerable to changes in the SDR interest rate. The staff may therefore wish to clarify its view that nonremunerated tranche positions can change substantially over time.

The question of equity in distribution and transparency can be addressed effectively through raising the norm to 100 percent and leaving room for policy decisions to fix it periodically. This way, creditors, debtors, and those in neutral status in the years to come can contribute according to their quotas to finance administrative and capital expenses, deferred charges, and contributions to the SCA-1. This implies that the basic rate of charge would be that rate to be levied on balances subject to charges so as to yield an income sufficient to remunerate net creditor positions.

As noted by the staff, this requires a change in the Articles. We have suggested this avenue on previous occasions. We believe that the Fund should actively pursue this objective. The current climate of historically low interest rates should be considered a helpful environment in which to embark on this line of action. We would encourage the staff to prepare the technical papers that would simulate the distribution of costs, the remuneration coefficient, and the final rate of charge. Mr. Autheman has suggested that this would raise difficulties for debtor countries if they have to repurchase in order to reconstitute the norm. Simulation exercises by the staff can be helpful here. Such a reconstitution requirement would be an important element in the discipline to keep administrative and capital costs as low as possible. It is equally important that we explore the broader issues dealing with the impact of changing one part of the Articles on the rest of the Articles.

If this avenue is closed, similar objectives can be reached through the application of part of the Fund's gold in a way to more broadly spread the costs of membership. This need not be an alternative; it could be a supplemental approach that we could consider at the same time. In this context, we recall in the 1950s and early 1960s, the Fund's operations, including administration and capital expenses, resulted in deficits. Ad hoc decisions were taken to make good those losses, namely, through gold transactions.

Beyond this, we are faced with inferior options. Among those presented by the staff, the one that seems worthy of consideration is the extension of burden sharing to cover administrative expenses and the net income target. However, the proposal's biggest drawback is that it fails to consider the contribution of nonremunerated tranche positions, and this becomes an unacceptable proposition.

There are, however, three aspects that merit consideration. The first is reduction of the net income target to 3 percent of reserves, the level that was set in 1982. It may be noted that this reserves target was subsequently raised to 5 percent against a background of increasing arrears without a safety net to maintain the Fund's financial integrity. Since then, two Special Contingent Accounts have been established, and contributions from the debtor and creditor members are continuing. Moreover, progress has been made in reducing the arrears problem, while policies have been tightened to minimize their future occurrence.

Second, the situation of the SCA-2 requires urgent review. The original expectation was that, within five years, debtor and creditor contributions would reach SDR 1 billion. However, in view of the constraints faced by creditor members, a longer period should be considered for accumulating the target amount. The staff proposes limiting the adjustment to the rate of charge to 4 basis points, and we support this.

Third, consideration should be given to removing the sublimit on the remuneration coefficient, now fixed at 85 percent of the SDR interest rate, to 80 percent as prescribed in Article V, Section 9. It is noted that the potential exists for burden sharing of deferred charges and contributions to the SCA-1 falling short of the required amount on account of reaching the floor of 85 percent--particularly, when interest rates are low. It is desirable that this be avoided as far as possible.

We do not know why the architects of the Fund's Articles did not explicitly address the question of the cost of financing the Fund, much less the question of its distribution. But the history of the Fund's operations does contain a message. Remuneration was not provided until 1969. With the Second Amendment in 1978, when the SDR interest rate was brought closer to the market rate, the rate of remuneration was reduced to 90 percent of the SDR rate. And, after the SDR interest rate was fully equated to the market rate in 1981, remuneration was still set at a discount of 85 percent. Once remuneration was equated to the market rate in 1987, nonremunerated tranche positions took over the role of offsetting the resultant upward pressure on the rate of charge. Thus, rightly or wrongly, up to 1987, by keeping the financial cost of resources used in operations artificially low, the rate of charge was held below market rates. The reasons for this have been succinctly set out by Mr. Marino and Mr. Zoccali, and I could not agree with them more.

Mr. Mwananshiku made the following statement:

The weaknesses in the present system of financing the Fund's operations have been well articulated in the staff paper, and I agree broadly with the conclusions reached. In particular, I note that the redistribution of the financing burden to ensure equity between the debtor and creditor groups, as well as promote fair participation by all members, is critical to the effective operation of the Fund as a cooperative institution. However, there seems to be little that can be done in the short term to redress the concerns highlighted in the staff paper. Indeed, the staff admits that the options available under the present Articles of Agreement are limited, and those proposed for our consideration seem to offer little appeal.

The proposal to extend burden sharing to cover administrative expenses and the net income target is not likely to yield a perceptible fall in the relative share of the financing burden currently borne by the users of Fund resources. Indeed, this chair considers the present burden-sharing arrangements as inequitable. While the floor prescribed for the rate of remuneration, at 80 percent of the SDR interest rate, will continue to protect the income of creditors, debtors would remain as exposed as they are under the current arrangements. Besides, members that do not use the Fund's resources or maintain a creditor position with the Fund would still be excluded from the financing arrangements, although, as Mr. Smee has indicated, the numbers are not significant.

The second option relates to administered accounts. This option should be examined further, as many Directors have indicated.

With regard to technical assistance, I do not support the proposal to charge recipients of short-term technical assistance or raise the contributions of recipients of long-term assistance. As Directors are aware, such assistance is provided to facilitate the implementation of adjustment programs in countries contending with serious external financial imbalances. An imposition of charges would seriously affect the implementation of their adjustment programs and could even lead to additional costs in other areas, such as prolonged and frequent staff missions. Besides, it could jeopardize the mobilization of technical assistance resources from the international community, which are currently helping to reduce the pressure on Fund resources.

In the longer term, there seems to be some room for maneuver in modifying the current financing arrangements to redress our present concerns. Relevant aspects of the Articles of Agreement could be amended to accommodate agreed changes. Each of the alternatives proposed by the staff has its shortcomings, some of which have been identified in the paper. I would, in particular, express my reservations on the proposal to reduce the SDR rate or delink the rate of remuneration from the SDR interest rate by lowering or eliminating the floor of the remuneration rate. This could render investment in SDRs or the maintenance of creditor position with the Fund unattractive. Perhaps the staff could elaborate more on the implications.

The option that provides increases in the overall size of nonremunerated resources of the Fund seems to offer some attraction as it could help reduce overall operational costs. In this regard, the proposal for the maintenance, by all member countries, of quota-based nonremunerated positions merits further consideration. I agree that such credit positions should be adjustable so as to meet increases in targeted costs. Credit contributions by all members should be limited to an amount that would cover only the imputed costs of basic membership privileges, rather than the total costs as suggested by the staff. I also agree that the nonremunerated positions should be made available to the Fund, but every member should be free to count its contribution as part of its official reserves. Further details of this proposal would need to be worked out if this option is to be adopted.

I look forward to a discussion on the possibility and implications of selling gold.

Mr. Bergo made the following statement:

I appreciate this opportunity to discuss alternative ways of financing the Fund's expenses. The staff paper gives an illuminating and thorough description of how the Fund's administrative and operative costs are covered. In so doing, it demonstrates clearly the complexity and nontransparency of the present arrangements, and could easily leave an impression of arbitrariness and lack of overall design in the financing of the Fund. This impression tends to be further strengthened if one goes beyond the material presented to look at the contributions to burden sharing by individual countries.

It is true that all members finance some part of expenses. The imputed costs of the nonremunerated creditor positions are high, and they cover a large part of the administrative expenses and precautionary balances, and thus also of the total costs of financing the Fund.

This notwithstanding, the bulk of the costs incurred by the Fund today is financed on the basis of members' operations with the Fund. Such a system thus excludes additional contributions from members that have a neutral financial position in the Fund, leaving them with a relatively small burden. Furthermore, as already mentioned, the financing system is complex and not sufficiently transparent. In my view, there is a need to review these aspects of the system.

The intellectual case for a profound overhaul of the system for financing the Fund is a strong one, and has been eloquently argued by Mr. Marino, Mr. Posthumus, and Mr. Zoccali. I have sympathy for many of their arguments, including that many of the benefits derived from the Fund's operations are systemic in nature, and this, ideally, should be taken into account when determining the system for covering administrative costs and burden sharing.

When prioritizing future work in this area, however, my authorities hold the view that, for the time being, the staff should concentrate its efforts on changes within the framework of the present Articles of Agreement.

While I agree with others that some of the possible changes might not imply any significant step forward--for example, including the Administrative Budget in the burden-sharing mechanism and charges for technical assistance--they should probably be seen more as a tool for prioritization in that area rather than as a possible large source of income for the Fund, even though this last aspect should not be overlooked. There are, however, other changes that potentially could have more effect.

In this context, the Fund should take a closer look at the system for selecting currencies under the Fund's operational budget, paying due regard to the need for the Fund to use usable currencies. Moreover, we support further work on introducing charges for operating administered accounts, and on charges for technical assistance, even if mostly for reasons other than purely budgetary ones.

The possibility of reducing the SDR rate has been mentioned and could be studied further. This option would, however, have to be weighed carefully against the reduced attractiveness of the SDR as a reserve asset that it would imply. It is recognized that further studies might lead to the conclusion that there is limited scope for corrective measures within the framework of the present Articles of Agreement, and a number of Directors seem to draw that conclusion on the basis of present evidence alone.

My authorities would not totally rule out examining proposals implying changes in the Articles of Agreement, but feel that such studies should be given low priority at present, owing to the considerable complexity of the process of amending the Articles. On a personal note, let me add that, among the proposals put forward, I find Mr. Posthumus's proposal to equalize, and, if necessary, increase the unremunerated reserve tranche intellectually attractive.

Mr. Kaeser made the following statement:

Let me state from the beginning that, in general, I am in favor of the present financing arrangements, although I agree that there is some room for improvement. The present system of financing the Fund's operations may appear complex--somewhat nontransparent--as a result of multiple, often painful compromises. Nevertheless, it has worked well so far. As stressed by Ms. Lissakers, the use of Fund resources is substantially cheaper than World Bank loans. I therefore do not see any urgent need for radical changes.

According to the present financing arrangements, the bulk of the costs incurred by the Fund are financed on the basis of members' operations with the Fund, and I do not have any problem with that. I understand that this can have some negative implications: for instance, the smaller the operations with the Fund, the greater the burden on those members using the Fund's resources or that are providing resources to the Fund through the operational budget. Another consequence of the present arrangements is that not all members are called to bear a share of the costs of running the Fund. However, in the present circumstances, these side-effects can be considered as minor. Rather than discussing the modalities of financing the Fund's expenses, I would attach greater priority to containing the rapid increase in administrative expenses that has been experienced in the recent years. This chair therefore welcomes the budgetary consolidation announced by the management. On applying charges to technical assistance activities, I stated in a previous discussion that the recipient countries should bear local costs.

Even if I share the concern of previous speakers regarding fairness, I am not too worried about the 18 members, with an aggregate quota share of 2.7 percent, that do not contribute frequently to the Fund's financing. Their position as "special guests" might well be temporary. I hope that their external position will improve so that they will contribute to financing the Fund through the operational budget and participation in burden sharing. If, however, their balance of payment situation were to worsen, they would probably have to use Fund resources and consequently pay charges.

I am also broadly satisfied with the present burden-sharing arrangement, which allocates the administrative expenses of the Fund and its precautionary balances fairly equally between debtor and creditor countries. The SCA-2 was established in 1990 to protect the Fund against the financial risks that arise in connection with the encashment of rights. It was planned to accumulate, over a period of approximately five years, an amount of SDR 1 billion. To date, the amount accumulated in the SCA-2 has been only SDR 568 million. To overcome this shortfall, one can break the link between the rate of remuneration and the SDR interest rate so that the rate of remuneration would not be subject to a floor in terms of the SDR interest rate. One can also lower the floor to the rate of remuneration. I am not in favor of proposals that require an amendment of the Articles. I would prefer instead to extend the accumulation period until the target amount of SDR 1 billion has been reached.

I also reject the suggestion to include the cost of financing the Administrative Budget as well as the net income target within the current burden-sharing arrangements. In the absence of any amendment of the Articles, this would lower the Fund's precautionary balances and further weaken the financial position of the Fund. Moreover, it would be easier to finance administrative costs and therefore give an incentive to increasing the Administrative Budget. As in the past, therefore, the Administrative Budget and the net income target should be financed mainly through charges.

Regarding the variability of the rate of charge and its link to short-term market rates, I do not see why the fluctuation of the rate of charge around the SDR interest rate represents a major problem. On the contrary, as shown in Table 1, the SDR interest rate fluctuates more than the rate of charge, which influences the debtor's financial burden. Although the rate of charge might increase in line with the SDR interest rate might, when the SDR interest rate falls--as happened during FY 1994--the rate of charge falls as well. In my understanding, the short-term SDR interest rate is a good basis for determining the rate of charge as well as the rate of remuneration because it reflects the situation in the international financial markets. In general, it favors the debtor as it is lower than long-term interest rates.

To conclude, my position is a conservative one, and from what I have heard so far, I am in good company. This does not mean that I would not be ready to revise it in the best interest of our institution, if developments call for it. In this respect, I must say that I would have preferred to have this discussion after we considered the appropriate level of the Fund's reserves for the coming years. I share Mr. Posthumus's goal to define a financial structure for the Fund flexible enough to generate sufficient income to cover reserve and other requirements regardless of the circumstances, while maintaining a certain degree of fairness among the membership. I must, however, confess that I have some difficulties in fully assessing any new suggestion without the support of some practical projections.

The proposal to establish a common norm below 100 percent for all member countries is interesting. I am willing and eager to consider it in all details. I therefore associate myself with other speakers in asking the staff to develop this issue, including the implications for the allocation of costs between creditor and debtor countries.

At the same time, I can already anticipate the opposition of this chair to a quota-based solution triggering, inter alia, the direct involvement of the UN General Assembly, which inevitably would change the nature of the Fund.

Ms. Lissakers said that she agreed with Mr. Kaeser on the need to link the discussion on burden sharing with the Board's consideration of net income and administrative costs. It would have made more sense for the Board to consider what the burden was going to be before it turned to how to allocate that burden.

Mr. Jaramillo made the following statement:

As we mentioned during the Fund seminar on this topic two years ago, this chair favors a quota-based system of financing the costs associated with Fund operations. In this connection, Mr. Posthumus has suggested increasing the amount of interest-free resources available to the Fund. To achieve this, he proposes the adoption of a uniform norm for remuneration for all members, *coupled with some mechanism to ensure that either all member coun*tries maintain the amounts dictated by this norm as SDR- interest-free deposits placed in the Fund or, alternatively, that members who withdraw their nonremunerated reserve tranche be charged for its use. The latter, if I remember correctly, was part of Mr. Wright's development of Mr. Posthumus's proposal. Mr. Marino and Mr. Zoccali also suggest a similar approach.

By linking interest-free resources to the quota of individual countries, and by using the returns that the Fund may obtain through using those interest-free resources to finance the cost of financing the Fund, these schemes permit financing such cost strictly in proportion to quotas. Exactly what cost items would be defrayed in this fashion would probably require a detailed analysis by the staff, as would the problem of instability of income streams resulting from interest rate fluctuations.

The proposal goes to the core of the discussion on financing the Fund. The Fund is a cooperative institution whose basic objective is more surveillance than finance. As a cooperative institution, we believe that its costs should be quota based. If one views the financing function of the Fund as incidental, the proposal gathers even more force: the financing of administrative costs would not depend on who is receiving Fund finance and who is providing it. Instead, it would depend, as it should in a cooperative institution, on the relative shares of members.

Regarding present arrangements, one is tempted to imagine a miraculous situation in which the Fund is so successful in its mandate that all its members cease to require Fund support for their balance of payments. Under this happy scenario, Fund credit would disappear. The irony, however, is that if cost-financing trends continued as at present, the Fund could go broke, because such a successful outcome would drastically reduce the amount of income that the Fund would require to carry out its duties. The institution would thus have to seek alternative sources of income.

We mention this outcome only to stress that it does not make as much sense, as it appears at first glance, to base the financing of Fund activities mostly on resources derived from its lending activities.

The use of an equal, nonremunerated portion of the reserve tranche for every member, which would be variable according to periodic needs, would be an operative way to ensure that contributions to defraying Fund costs are made without the need for members to go, year after year, to their legislatures for approval of a quota-based contribution.

It is true that, like other nonvoluntary quota-based sharing mechanisms, such a proposal would have the disadvantage of requiring an amendment of the Articles of Agreement. However, in view of the advantages in terms of equity and transparency of moving toward a quota-based system of financing certain Fund costs, we believe a proposal along the lines suggested by Mr. Posthumus and others should be the alternative chosen by this Board, despite the difficulties associated with an amendment of the Articles.

As we suggested two years ago, and as has been mentioned today by several speakers, further thought should be given to the possible mobilization of part of the Fund's gold holdings as a way to increase interest-free resources that could, in turn, be used to finance the institution's financing operations. While it is true that strong Fund reserves are required to safeguard the institution against possible losses, including those arising from overdue obligations, a partial liquidation of gold holdings would not reduce Fund reserves but instead, would change their composition, increasing the portion that could become interest bearing, and thus contributing to defraying the cost of financing the Fund.

Mr. Santos made the following statement:

The staff paper gives a concise overview of the costs incurred by the Fund in carrying out its mandate and the various means by which these costs are financed. It also explores alternative ways to distribute these costs across the membership. This is not an easy task when we take into account the complexity as well as the contentious nature of the issues involved.

When discussing these issues, we should keep in mind that the Fund is a cooperative institution, which implies that considerations of equity and fairness are paramount when it comes to sharing the benefits and costs of its operation. While these principles are being applied to some extent under the present system of burden sharing, which--as some colleagues have reminded us--is a hard-gained compromise from a long and contentious process of negotiations in the Board, in our view, there is room for improvement.

In this context, we have reviewed with great interest the different alternatives for financing the Fund's expenses as proposed by the staff, and which imply either changes within the framework of the present Articles of Agreement or a more radical approach through amending the Articles. Most of the issues involved have been discussed by previous speakers, and my remarks will therefore be brief.

The changes suggested within the framework of the present Articles fall short of meeting our basic expectation of establishing a system that is permanent and is seen as fair and equitable by the whole membership. Unfortunately, the changes that can be made without amending the Articles are limited in scope. They could prove to have little impact in financial terms and would not lead to meaningful changes in the present system of burden sharing.

As to the proposals that could be implemented only in the context of amendments to the Articles, we would not deny the attractiveness of alternatives that draw on distribution systems that are quota based. In this regard, the approach proposed during a previous Board seminar by Mr. Posthumus and the U.K. chair, and discussed in the staff paper under the heading "a uniform norm and nonremunerated position," deserves our attention. We recognize, however, the difficulties that derive from the fact that debtor countries in general would have to replenish their unremunerated reserve tranche positions. Therefore, we would be interested to hear the staff's response to Mr. Mirakhor's question on the amount of nonremunerated position to be maintained by each member under this approach. For all that has been said, we share the view that further elaboration is needed to clarify how the system would work in practice. Mr. Marino and Mr. Zoccali have also drawn our attention to the need to explore options for the partial mobilization of the Fund's gold holdings in order to defray the costs of operating the institution.

To conclude, I look forward to further discussions in the Executive Board on these issues.

Mrs. Hetrakul made the following statement:

In general, I can associate myself with Mr. Marino and Mr. Zoccali.

The review of burden sharing is welcome in light of the expansion of the Fund's membership. I agree with my colleagues that the costs of operating the Fund should be distributed more equitably among members and should be simplified to enhance transparency in the Fund's policies.

I prefer the quota-based cost-sharing method so that all members participate in the allocation of costs in proportion to their rights and obligations in the Fund rather than having only creditors and debtors share the burden.

From the staff paper, it seems that the only way we can arrive at an "equitable" method is to amend the present Articles of Agreement.

Regarding the three schemes that would involve amending the Articles, the option to break the link between the rate of remuneration and the SDR interest rate would not fulfill the objective of equity. The burden would be shifted to creditors, while the third group of members--those who hold "neutral" positions in the Fund--would still be excluded.

I do not favor the option to levy a charge on the basis of members' quotas for the reason given by the staff: such a levy would be subject to regular budgetary review by the UN General Assembly and would be unacceptable in terms of practicality.

I am in favor of the equalization of the norm for remuneration option as it would best suit the objectives of equity and simplicity. I encourage the staff to outline the detailed process to be followed in this area and proceed with it. The question of what expenses should be financed should be made clear.

Allow me to again bring up a proposal made by Mr. Arora and endorsed by the Interim Committee several years ago. It was proposed that members that contribute less than 1 percent of their quota under the current burden-sharing mechanism, taking into account the unremunerated reserve tranche, should participate in making voluntary and highly concessional or interest-free loans to the Fund. The modalities of this mechanism were presented in a staff paper, but the matter was not brought to the Board for discussion because of the lack of wide support and doubts about the mechanism's effectiveness. I wonder whether this proposal merits a second look: it seems to ameliorate the equity problem and yet does not involve the tedious process of amending the Articles of Agreement.

Mr. Waterman made the following statement:

The staff has done a good job in presenting the issues on an extraordinarily complex topic. At the same time, I would not like the job at present of trying to explain the issues to my Minister. I can see his eyes glazing over now.

However, we have always been in favor of a quota-based burden-sharing arrangement and believe that such a system could be both more transparent and more equitable. Of the quota-based or related options, the quota-based levy and the norm and nonremunerated reserve option advocated by Mr. Posthumus would have similar effects, and it could be useful to have further work done on both. I do not necessarily see one as being superior to the other, in that the transparency of the Fund's operations and parliamentary oversight are important issues, as long as the prospects of parliaments and the United Nations getting involved in the Fund's operations are not particularly high.

We are not attracted to breaking the link between the rate of remuneration and the SDR rate. Realistically, like many other speakers, we do not think the prospect of changing the Articles is a particularly high probability at the moment, and I certainly do not see this as a major issue facing the Fund today. I would join Mr. Smee in arguing that, if the Articles were to be changed at some time in the future, it would make sense to do that when you were considering other, more significant changes. But given that, it would be useful to do some further work on the possibility of charging for the operation of administered accounts and for technical assistance, and perhaps that is something that could be carried forward initially by the budget committee. In saying that, I recognize that it will not necessarily involve large amounts.

We do not see much merit in extending burden sharing to cover administrative expenses and the net income target for the reasons outlined by Mr. Al-Jasser, and others.

Mr. Zhang made the following statement:

At the outset, this chair endorses the general principles of equity, fairness, and transparency in dealing with the cost of financing the Fund and its distribution. I also welcome this timely overhaul of our present financing arrangements in line with these principles. The staff has presented various comprehensive and significant measures for consideration in exploring alternative ways of financing expenses, which could have a far-reaching impact on the functioning of the Fund's financial operations in the years ahead.

With regard to financing the Fund's operations and transactions based on members' quotas, I can see the fairness of this approach, but I share the staff's view that debtors and creditors can share the financing of the Fund's other expenses and precautionary balances. In light of the above and in view of its significant implications for the Fund and national authorities, it is my view that there should be more elaboration on this issue and a general agreement regarding the methodology underlying the quota-based burden-sharing approach.

I have no difficulty in agreeing with the extension of burden sharing to cover administrative costs and the net income target. Therefore, it is expected that the direct and positive immediate result of the proposed extension would be a reduction in the rate of charge. As pointed out in the staff paper, the burden-sharing arrangements would continue to exclude those members who hold a neutral position in the Fund. To reduce the burden of the debtor members, I wonder whether the existing burden-sharing scheme can be broadened to include those neutral members in the proposed extension of the burden-sharing mechanism.

On the issue of levying a charge for administered accounts, we believe that it would be appropriate for the Fund to consider levying such a charge. However, I would appreciate the staff's comments on the extent of the resources to be generated from this operation.

As to charging for technical assistance provided by the Fund, this chair reiterates its strong disagreement with this suggestion. In light of its proven effectiveness and the importance of technical assistance in facilitating the adjustment and reforming process of developing countries, especially in strengthening program countries' institutional capacity to better implement Fund-supported programs, levying such a charge would, as the staff points out, deter members, particularly low-income countries, from requesting needed assistance and severely curtail the Fund's role in assisting its members in improving their macroeconomic policies.

I can see the rationale for giving consideration to levying an annual assessment in proportion to members' quotas. However, as the staff points out, a number of questions and difficulties have arisen, which I recognize. As I mentioned earlier, a general agreement needs to be reached before introducing a new scheme requiring substantial revision of the Articles.

On the issue of the link between the rate of remuneration and the SDR interest rate, during several Board discussions on the annual review of the Fund's income position and its precautionary balances, although a positive attitude was expressed about the link between the rate of remuneration and the SDR interest rate, the associated volatility of the SDR interest rate and its adverse impact on the predictability of net income cannot be denied. In view of this, and in lieu of avoiding a sharp shift in policy, I tend to endorse the proposal to reduce the lower limit of the remuneration coefficient.

We fully agree with the staff and are inclined to support the suggestion that the norm and nonremunerated position be made uniform to achieve a more equitable distribution of financing for the Fund.

It will not be an easy task to find a better scheme that can accommodate the various concerns expressed by Directors. However, the staff is encouraged to continue to explore alternatives that respect the basic principle that the burden for debtor countries should not be increased under any solution. On the role of the Fund's gold holdings, I share the views of Mr. Marino and Mr. Zoccali.

Mr. Prader made the following statement:

The staff paper discusses a number of interesting issues connected with a more equitable distribution of the cost of financing the Fund and usefully demonstrates the fallacy of assertions that there is an inequity in burden sharing between creditors and debtors. According to Table 3, both groups appear to have contributed about equally to support the Fund's administrative expenses and precautionary balances. Besides debunking the myth of creditor-debtor inequity, the staff paper effectively displays the pros, cons, and contradictions of alternative schemes.

It is legitimate to ask whether there is now a reason, or a more urgent reason, to question the present method of financing the Fund. Have concerns about equity between debtors and creditors become overwhelming now that world interest rates and the rate of charge have declined significantly? Has the desire for greater equity in distributing costs among dissatisfied creditors become stronger despite the fact that all our divisive discussions on the operational budget were stalemated? Is the agitation for putting an alternative scheme on the agenda coming from an alliance between discontented debtors and creditor countries whose preferences for higher Fund reserves have not been clearly spelled out? Is our discussion prompted by perceived inequities in the distribution of the burden of financing the Fund, or by anticipated inequities in the event of a decision to adopt a different level of Fund reserves?

In any event, as a number of relevant discussions are still ahead of us, questions regarding possible alternatives on a comprehensive issue like the cost of financing of the Fund cannot be answered until we know more about such crucial variables as the Fund's next Administrative and Capital budgets, or the outcome of our future discussion on the Fund's precautionary balances, which in turn depends on our future policy toward Russia, among others.

Absent the results of these discussions, the members of my constituency views today's discussion as highly theoretical. They cannot now take a position on whether to reform the present system of financing the Fund. However, it is already clear that the creditor countries in our constituency would strongly object to further lowering the floor to the rate of remuneration, or decoupling the rate of remuneration from the SDR interest rate, or--as suggested by one speaker--reducing the SDR interest rate. The latter proposal would effectively destroy the SDR because it would increase the already strong reluctance of creditor countries to hold SDRs and would seriously damage the status of the SDR as a reserve asset. I should also mention that for at least one creditor member of our constituency a satisfactory resolution of the issue of equity among creditors contributing to the operational budget and burden sharing would have to precede any discussion and agreement on equity between creditors and debtors, because the likely direction of any reform in the latter area would be toward increasing the contribution share of the creditors, which under the present system means a higher share for creditors with high reserves but low quotas. Our chair agrees with the staff's a priori exclusion of sales of gold as a means of meeting the costs of financing the Fund, although the possibility of generating more Fund income through gold transactions, such as swaps and the like, is another matter.

Some of the reform options seem interesting, but it would be sensible to disregard those that can produce only marginal advantages over the present system, such as charging for services rendered by the Fund. In the end, only one or two of these options have attracted any sympathy in my constituency. One is the notion of extending burden sharing to administrative expenses and the net income target, preferably within the framework of the present Articles of Agreement. It seems only fair to ask that all Fund members contribute to the Fund's financing during a period of extraordinarily high administrative costs. Unfortunately, there is no way of bypassing two major obstacles to such an extension: first, as the present floor to the rate of remuneration was reached some time ago, it would reduce the creditors' share of the burden of precautionary balances; and second, it would exempt the so-called neutral countries--those that are neither creditor nor debtor--from having to pay any of the costs of financing the Fund.

The advantage of Mr. Posthumus's proposal, which specifically addresses the problem of the neutral countries, is that it appears to inject a certain degree of equity while simultaneously avoiding, through its technical operation, the political pitfalls of an unenforceable direct levy on Fund members. However, this proposal has problems of its own. While it seems to satisfy those Fund members who wish to see quota-based burden sharing, it will probably operate largely at the expense of countries with high quotas.

Aside from the question whether these members are actually willing to accept this outcome--an altruism that was absent from the operational budget debate--there is probably no way to avoid that even this appealing proposal involves redistributing the burden toward creditors. One member of our constituency would like to see the financing accomplished by adopting Mr. Posthumus's proposal but limiting it to administrative costs and the precautionary balances. Even though nothing can be ruled out, not even a change in the Articles of Agreement, there is much room for skepticism about whether amending them for this purpose is worth the effort. In any case, before taking a position on this proposal, my authorities would like to see some illustrative calculations on the costs of this proposal for individual Fund members.

For the time being, our chair would tend to agree with the conclusion that despite certain problems--such as transparency--the present system is probably still the option of choice, and could not be modified without creating major frictions by reopening the interminable debate about equity among creditors, and equity between creditors and debtors. Short of engaging in a redistribution discussion, the only ways of easing the Fund's financial position are to contain its administrative costs by a policy of strict budget control and to avoid the need for higher reserve accumulation by prudent Fund lending and better policies in the recipient countries. All of these options can be influenced by the authorities, by the Executive Board, and by the Fund's management.

Mr. Lanciotti made the following statement:

Like all previous speakers, I greatly appreciated the useful staff paper, which provides a thorough and comprehensive overview of the problems related to the financing of the costs incurred by the Fund's operation. The solution of these problems is not easy, as witnessed by the number of staff documents and the large amount of Board opinions which have been produced in the latest years. The background paper for today's meeting, by summarizing the current "state of the art", stimulates the discussion toward future solutions, on the grounds of ideas and opinions put forward by Directors in past meetings and reviews of this crucial issue.

Let me remark that, like any policy option those in front of us today are subject to the challenging trade-off between equity and efficiency. The status quo does not, in the opinion of many, seem to fully meet either of the requirements, since such methods, according to the Directors' opinions reported in page 16 of the document, would "fall unevenly on individual members", "give rise to relative instability of the rate of charge," and "[be] somewhat inflexible in meeting new costs."

In my opinion, it is in the light of the above-mentioned criteria, that the alternative proposals put forward in the document, both those which involve or do not involve changes within the framework of the present Articles, are to be considered, in order to have an appropriate comparison.

Concerning equity, I am in total agreement with the staff's statement that it is essentially a matter of judgment; I do believe, nonetheless, that an estimate of the financial impact for each country of contributing to the costs of operating the Fund under the different proposals, would be a major step ahead in reaching what the staff defines "a comprehensive system that would be widely perceived to be broadly fair." It would be a step ahead along a difficult road, given the conflicting interests of creditor and debtor countries, as Mr. Zoccali has clearly pointed out.

As for efficiency, I think that a perhaps narrow, but practical, definition should limit itself to considering the ability of the proposals to meet new costs in front of any change in the external environment, that is, to be financially robust. Also in this case, a quantitative assessment of different alternative scenarios, which take into account different assumptions on the relevant variables, could be a useful tool.

Accordingly, I welcome the invitation by the Staff to "indicate the areas...in which further staff work should be undertaken" by suggesting the elaboration of alternative scenarios. This was already done in the past on particular occasions and could be a helpful support for the Board decisions.

At the moment I simply would like to express the opinion that those proposals involving changes in the framework of the present Articles are to be regarded very carefully, in light of the various institutional problems that, perhaps in differing measures, are involved. At first glance, this group of proposals, at least those that would distribute the costs among all the countries proportionally to the quota, or some quota-related concept, seem to have a relative advantage in terms of equity. The proposal of Mr. Posthumus, in particular, amended with Mr. Wright's suggestions, brings the additional advantage that it would overcome many of the political and institutional problems associated with the quota-based distribution of costs, remaining intrinsically similar. A former simulation of the staff of this proposal did not arrive at clear-cut conclusions. I think that the proposal deserves further analysis in order to obtain a clearer idea of the costs and benefits involved.

Concerning the other group of proposals, which do not imply a change in the Articles, I do not, in principle, disagree with the introduction of charges or fees for the Fund's services. I have already pointed out, as have other speakers on the occasion of the recent Review of Fund Technical Assistance, that the need for theses resources is to be administered efficiently; using fees could encourage the best use thereof. Nonetheless, the question is whether introducing such charges could be a solution to the problem of addressing at least a part of the costs of operating the Fund, considering also that it is likely to raise a problem of equity. Mr. Posthumus suggests that the amount of additional income involved would probably be small anyway. In conclusion, it is my impression that, given the importance of the issues involved, the measurement of the effects of the different policy options under discussion requires more precise measurements and assessments.

Mr. Mozhin made the following statement:

Since we did not participate in the 1992 Executive Board seminar discussion on this matter, this is our first opportunity to comment on the costs of financing the Fund and their distribution. I have to say, first, that I broadly associate myself with the criticisms of the present financing arrangements that have been expressed by Executive Directors on previous occasions. One can hardly disagree that, under the existing system, the costs of financing the Fund fall unevenly on individual members and depend on the level of their involvement in the Fund's operations and transactions. Other problems associated with the present system are the relative instability of the rate of charge and its relative inflexibility as regards the task of meeting new costs.

I strongly support the idea of including the cost of financing the Administrative Budget and the net income target within the framework of the present burden-sharing arrangements. However, such a measure would be effective only in the event that the rate of remuneration does not fall below its floor of 80 percent of the SDR interest rate. At the same time, such a measure would be only an extension of the present system and would not eliminate its shortcomings. I therefore agree with the view that the necessary changes can not be achieved without an amendment of the Articles of Agreement.

I believe that the combination of the two measures--the lowering of the floor to the rate of remuneration and equalizing the norm of remuneration for all members as described in the staff paper--would result in a substantial and sufficient improvement of the system of financing the Fund. I would therefore encourage the staff to examine further the ramifications of these suggestions.

Mr. Posthumus observed that the discussion had so far focused more on burden sharing and the issue of equity than on the cost of financing the Fund. When he first came to the Fund, he had had to consult several books as well as the Articles of Agreement to find out how the Fund was being financed. Concluding that the nonremunerated resources of the institution would remain fixed in absolute terms, except for the precautionary balances, while the activities of the Fund, and their attendant risks, were expanding, he questioned whether the arrangements for financing the Fund were sustainable. Subsequently, he had raised the issue in the Board with a view to averting a problem rather than having to face it later.

He did not want to open the Pandora's box of amending the Articles of Agreement, Mr. Posthumus stated. His experience with the Third Amendment led him to urge caution in that regard, and he fully agreed with other Directors on the need to avoid such a process if at all possible. He also agreed with Ms. Lissakers that the Board had first to look at the burden before it discussed burden sharing. In that regard, it should be kept in mind that the Fund was not only a financing institution; it had broader responsibilities, including the major task of surveillance.

Mr. Autheman said that in his view, the issue of the Fund's gold, including gold sales, gold swaps, and other techniques for deriving income from the management of the Fund's gold stock, had to be addressed in itself. In addition, there was the question of how the revenues realized from mobilizing gold should be used. In his view, the Fund's gold holdings constituted its reserves and therefore income from managing the gold stock should be put to the Fund's reserves.

In the past, his chair had suggested that the Board should consider gold swaps, Mr. Autheman recalled. In that regard, a distinction had to be drawn between operations in the market and operations with central banks or public institutions. Market operations should not be considered unless a decision was taken to change the way the Fund handled its gold stock. If it was judged that opportunities existed for gold swaps, transactions could be considered with either the Bank for International Settlements or central banks.

He was skeptical about a revolutionary approach to burden sharing, Mr. Autheman remarked. The Articles of Agreement were the Fund's constitution, and they should be changed only when the institution was faced with a critical problem. Instead, greater attention should be devoted to a step-by-step approach. For example, one step was the recent decision on the net income target. A second might be the proposal to reduce the contribution of debtors to the SCA-2 so as to take into account the lag in contributions by creditors.

He agreed with Ms. Lissakers that the Fund's policy on building reserves should be assessed before considering the policy on burden sharing, Mr. Autheman stated. The last general review of that issue had been held in 1990, at which time the Board had decided to accelerate the accumulation of reserves under the arrears strategy and to change the burden-sharing formula. That pragmatic approach should be followed in the future.

Mr. Fernando said that in the event that the Fund seriously considered the use of its gold, he could more easily understand transferring profits from gold sales to reserves and treating income from other types of transactions in gold as part of the Fund's income, because the former represented a realized capital gain while the latter did not result in a reduction in the stock of the Fund's gold.

Mr. Marino remarked that he agreed with Mr. Posthumus regarding the focus of the discussion so far. In fact, one of his concerns was that the distribution of the cost of the Fund seemed to be more a result of chance than of policy, and the Board should not be satisfied with that framework. The major issue was how to finance the cost of the Fund at the margin. In that context, it was clear that all increases in nonoperational expenses were borne mainly by debtor countries in a 70:30 ratio. For those Directors who believed that the Fund was a cooperative institution, intended to support those countries facing severe balance of payments problems, the distribution of nonoperational expenses at the margin continued to be a great source of concern.

The Treasurer, commenting on Mr. Jaramillo's point that the Fund could go broke if members had no need to borrow from it, stated that the volume of reserve tranches that could accommodate all repurchases outstanding was small and, therefore, repurchases would eventually have to be made in SDRs, which would generate income even when there were no further purchase transactions. The Fund would not go broke if there were no lending by the Fund.

There had been two major changes in recent years in the Fund's financial position, the Treasurer observed. One was the emergence of arrears, which are regarded as temporary. The financing element associated with arrears, which was by far the biggest part of the cost of financing the Fund, should diminish over time. That would be an important consideration in contemplating changes in present arrangements over the medium term, and particularly when reviewing the Fund's reserve policies and the adequacy of its precautionary balances. The second, protracted change, essentially a transition, had arisen with the coming into force of the Second Amendment, which left unresolved the question of what to do about the nonremunerated reserve tranche positions because the Fund did not have the resources to set the norm--which was the intent of the framers of the amendment--at 100 percent of quota. The fact that it was intended eventually to achieve a remuneration norm of 100 percent of quota implied that the rate of remuneration in terms of the SDR rate might need to be adjusted periodically toward the floor of 80 percent of the SDR interest rate. Thus, under the Second Amendment, the rate of remuneration could be regarded as a policy instrument given the authority that the rate of remuneration could vary further than 100 percent and 80 percent of the SDR interest rate. In fixing the rate of remuneration, account should be taken of the rate of charge on the use of the Fund's resources, which meant that the fixed costs of the Fund had to be taken into account.

The staff paper had not discussed gold as a source of potential investment income because its role extended beyond its financial implications for the Fund's income and cost structure--it had important systemic aspects, the Treasurer continued. As to gold swaps and other types of transactions, he recalled that the General Counsel had made a definitive statement on that issue more than two years earlier: the Fund could sell its gold, it could accept gold in the discharge of obligations, but it could not trade its gold.

Mr. Mirakhor had repeated his suggestion that the balances received in the Fund under burden sharing might be invested and a rate of return paid to those making burden-sharing payments. As had been explained at the July 1992 seminar, if remuneration were paid on balances in the SCA-1 and the SCA-2, a cost would be incurred that would have to be paid by debtors, which would undermine the burden-sharing arrangements, the Treasurer explained. Instead, payments to the SCA-1 and the SCA-2, as well as to the net reserve, were held in the General Resources Account and thereby eliminated that extra cost of remuneration, to the benefit of debtor members.

Under Mr. Posthumus's and Mr. Wright's proposal, the level to which the nonremunerated norm would be lowered would depend on the SDR interest rate and the level of the Fund's costs, the Treasurer commented. If all burden sharing and all administrative costs were taken together, at current interest rates the norm would be lowered by 13 percentage points to 87 percent of quota.

On the cost of establishing the administered accounts, it should be pointed out that the agreement on the Japan Technical Assistance Account included provisions to cover overhead costs, the Treasurer stated. When suggesting the imposition of charges for administered accounts, the staff had in mind the many accounts that had been established in connection with the clearance of arrears--the Bolivia Account, the Panama Account, and the Guyana Account, among others. The establishment of those accounts had taken a great deal of staff resources. Although it would be difficult to put a value on staff and Board inputs, the costs were not insignificant in terms of man-hours. Other possible trust funds and administered accounts could be large and would absorb a great deal of Fund resources. The cost of operating the enhanced structural adjustment facility and the structural adjustment facility (SAF), for instance, amounted to SDR 20-24 million a year, which was funded from the Special Disbursement Account. If another major trust fund were to be established--for example, in relation to any scheme of SDR redistribution--it might be appropriate to levy a charge for its administration. Charges might be set as a certain percentage--say, 1/4 of 1 percent or 1/2 of 1 percent--of the amount of resources flowing through the account.

As Mr. Al-Jasser had correctly observed, the rate of charge was not unstable, it was variable, the Treasurer stated. In the staff's view, there was no reason to change the current system of fixing the rate of charge in terms of the SDR rate. A number of Directors, however, considered the variability in the rate of charge to be somewhat disturbing, particularly when market rates were 10-12 percent and the rate of charge was about 6.5-7 percent. The variability of the system was one of the consequences of the market-related structure for financing Fund costs under the Second Amendment. He would not wish to make a judgment on whether, as Mr. Mirakhor had suggested, variability could lead to instability. As the SDR rate was linked to short-term interest rates in the five major money markets, the degree of variability was very much influenced by the monetary policies of the authorities in those countries.

Mr. Al-Jasser observed that the variability of the SDR rate had attracted more attention after 1987 even though it was in part less volatile in that period. It appeared that the SDR rate attracted attention when the rate of charge was somewhat higher than the SDR rate. Rather than change the system, it may be necessary to accept the cyclical variability in the rates of change, which reflected changes in global economic conditions.

Mr. Autheman said that while it was true that short-term interest rates varied with changes in monetary policies in the five major money markets, in his view, the relationship between the SDR rate and the rate of charge was not stable because the rate of charge varied less than the SDR rate. That worked to the advantage of debtor members by smoothing out fluctuations. The issue was whether the current situation was signaling that the intermediation cost was rising or whether it was temporary.

Mr. Mirakhor commented that if in the long term the trend was toward more variability, that would eventually lead to an unstable system.

Mr. Al-Jasser said that the alternative to variability was fixed rates, which would result in a system that was more untenable than the current one.

The Treasurer observed that it would be difficult to project whether the SDR rate would become more or less variable, because that would very much depend not only on the evaluation of market interest rates but also on the volume of balances subject to charge and the volume of balances subject to remuneration. The current relatively low variability reflected the fact that the totals of each of those two balances were approximately equal; if the balances differed substantially, then the relationship between the SDR interest rates and the rate of charge could diverse very considerably, namely, the cost of intermediation would increase.

Table 3 represented a simplification of the distribution of the cost of financing the Fund between creditors and debtors, the Treasurer remarked. Mr. Evans had made a valid point--namely, that the concessionality of the rate of charge had to be taken into account in assessing the creditors' share. He would, however, suggest that in making an assessment, Directors might focus on charges in excess of net operational expenses and on the imputed costs of the nonremunerated tranche position, so as to eliminate the impact of arrears and their financing, which were expected to be a temporary burden and to take into account that the burden-sharing mechanism provided for refunds as arrears were discharged.

The staff paper had only touched on the issue of reducing the nonremunerated tranche without amending the Articles because that raised the difficult question of whether the nonremunerated reserve tranche position could be taken in to account in distributing currencies under the operational budget, the Treasurer explained. During previous debates on that issue, it had been concluded that for legal reasons what had been intended under the Articles as regards the distribution of the nonremuneration on norms could not be deliberately undermined through altering the distribution of currencies under the operational budget.

There was no way to extend the burden-sharing arrangements to the "neutral" countries because there was no way to reduce remuneration that they did not receive or put a surcharge on charges that they did not pay, the Treasurer stated. That was one of the reasons underlying the "Arora" proposal that Mrs. Hetrakul had mentioned and the appeal to those countries, among others, that paid less than 1 percent of quota in burden sharing voluntarily to make a contribution of 1 percent. There was, however, no legal basis to provide for participation of neutral countries in the burden-sharing arrangements.

Mr. Mirakhor recalled that at the July 1992 seminar, the staff had promised to study his proposal further. According to the Chairman's concluding remarks, "while some of these ideas [Mr. Posthumus's and Mr. Wright's] would require a further amendment of the Articles--and, thus, could not be realized in the short term--the staff was encouraged to analyze further these and other suggestions, including some of those made by Mr. Mirakhor, and their potential impact on the Fund's financial position and structure."

The Treasurer said that the staff would look again at Mr. Mirakhor's proposal with a view to further statistical analysis. The outcome, however, would likely be as he had indicated earlier--an increase in charges paid by debtor members.

The Chairman made the following concluding remarks:

> We had an interesting exchange of views on a complex matter that goes to the heart of the life of this institution. It was worthwhile to have once again this discussion, even if it has not provided us with any unexpected breakthrough. While there was a wide range of views and divergence among Board members on a number of important points, most Directors made clear this morning that despite perceived inequities and lack of transparency in the cost of financing the Fund and its distribution among the members, Directors were very cautious about wanting to embark on an amendment of the Articles, which would be necessary if it were desired to implement a fundamental change in that distribution. There

nevertheless remains a widespread view that there are certain aspects that would usefully be reviewed further in due course.

There would appear to be a broad agreement on two general principles: first, that it is appropriate for members making use of the Fund resources grosso modo to bear the cost the Fund incurs to finance the extension of credit to its members; and second, that other costs incurred by the Fund in carrying out the tasks the membership wishes it to undertake--whether administrative expenses or operational costs or expenses related to prudential considerations--should be shared among members in a manner that is generally acceptable and is considered equitable by the membership as a whole. While views on what constitutes equity in this regard are likely to differ among Directors, a number of you today referred to the importance of quotas in many aspects of the Fund's work.

In the view of a number of Directors, the current system results at present in a relatively balanced distribution of the cost of running the Fund between its debtor members and its creditor members. However, other Directors noted not only that the composition of each of these two groups change over time, but also that there are perceived inequities in the distribution of these costs within each of these groups. Some of these perceived inequities arise from past decisions of the Fund that are reflected in the provisions of Articles--such as unremunerated positions--while others reflect the fact that the financing of the Fund is based on the volume of outstanding transactions, which itself is a variable, rather than on some more permanent standard such as the distribution of quotas. Several Directors observed that further successes with the Fund's arrears strategy would reduce the problem of financing the Fund and its distribution.

Directors commented on the alternatives mentioned in the staff paper to meet the Fund's nonoperational cost. As regards those that did not require an amendment of the Articles--an extension of burden sharing to cover administrative expenses and the net income target, investment of part of the Fund's assets, and a more comprehensive recovery of the cost of administered accounts and of technical assistance provided by the Fund--Directors considered that implementation of any one of these measures would have a limited impact on the overall cost of conducting the Fund in the short run. Nevertheless, there was interest--even if it is limited--in some of these ideas, particularly in more comprehensive cost recovery. I will ask the staff to follow up on methods for achieving this where feasible and desirable. The staff will closely monitor the cost of administering separate accounts established at the request of members and appraise the Executive Board of such costs, together with proposals to charge for such services if this appears warranted, and does not discourage generous contributions to the financing of the Fund. Here, we have to find appropriate solutions.

As already mentioned in the debate on technical assistance a few weeks ago, the staff also noted the wish of some Directors to monitor the administrative cost of providing technical assistance, and the issue of possible charging for such assistance will be pursued in the Committee on the Budget.

Other and more far-reaching measures to affect the distribution of the Fund's operating costs could not be implemented without an amendment of the Articles. Most Directors referred to the very different contributions to the Fund's financing that result from differences in the norms for remuneration, and there was very broad support for a further examination of a uniform norm for all members. The staff will proceed as requested.

A number of perceived difficulties arising with the cost of financing the Fund are related to the market-based determination of the SDR interest rate, and the close link between that rate and the rate of remuneration. However, Directors generally were not in favor of a change in the determination of the SDR interest rate, nor of reconsidering the link between the rate of remuneration and the SDR interest rate, and a number of you warned against any changes that would impair the reserve character of Fund-related assets.

Moreover, Directors generally agreed that the imposition of a quota-based levy would at this time be difficult to implement for the reasons given in the staff paper.

Finally, many Directors made reference to the Fund's gold, and expressed interest in a staff technical study on how the Fund's gold could be mobilized to produce income. Let me remind you, however, about the very limited scope for Fund transactions in gold under the Articles: the Fund can sell, or accept gold, but we cannot trade gold. In view of the sensitivity of the issue, I hope that references to the staff's study will be avoided. In the process, we will informally touch base with a few central banks that are involved in gold transactions.

Mr. Al-Jasser said that in view of the sensitivity of the issue of mobilizing the Fund's gold, he wondered whether there was sufficient Board support to justify a staff study of the matter. He had no strong views on the study, although he did not support any use of the Fund's gold.

The Chairman remarked that while his own position on the matter was conservative and well known, he considered that it was important from time to time for the Board to consider whether and how best to maximize the value of the Fund's gold holdings. It was important, however, that such an exercise be conducted quietly and with discretion.

The Deputy General Counsel observed that the Articles prescribed the possible uses of the Fund's gold and, in particular, the way in which its value could be realized. First, they precluded, in effect, a revaluation of the Fund's gold at the market place. Second, they prescribed that the value of the gold could only be realized through a sale. Third, techniques like swaps--even with official entities--were not available to the Fund to mobilize the value of its gold under the Articles. The Fund could sell gold. However, it would then have to place the equivalent of SDR 35 per ounce to the General Resources Account. The remainder--namely, the profit on the sale--was to be placed to the Special Disbursement Account. That separated the proceeds of a sale into two portions, thus creating one obstacle for the reversal of a swap. The second problem was that a swap would constitute a sale and repurchase at a fixed value. However, the Fund could accept gold only in discharge of obligations, and those obligations could not be of a contractual nature. Moreover, even in the case of acceptance of gold under an obligation, the gold would be valued at the market value at that time; the price could not be fixed from the outset.

The Fund was not authorized to use its gold for collateralization, the Deputy General Counsel explained. The Fund could only realize the value of its gold through a sale. Therefore, the Fund could not discharge an obligation from the gold collateral; it could not make a transfer of its gold. A particular technique had been used in the context of the ESAF, namely, a "pledge" of gold, which constituted a decision to sell a specified amount of gold when certain conditions were met. In essence, that involved an earmarking of part of the Fund's gold holdings and a decision to sell. It was not collateral in the formal sense.

The Treasurer, responding to a question regarding the carrying costs associated with holding gold, said that the Fund bore no current costs for the holding of gold in its four depositories. The imputed financial costs of holding gold were, however, extremely high. If the Fund's gold was sold at the official price, SDR 35 per ounce, and the value of the gold at the official price was deposited in the General Resources Account, the rate of remuneration would be reduced accordingly, and the amount saved, at the current low SDR rate, would amount to some SDR 200 million a year.

4. CIRCULATION PERIODS FOR EXECUTIVE BOARD DOCUMENTS

The Chairman recalled that he had circulated to Directors his views on circulation periods for Executive Board papers, which could be summarized as follows: it was difficult to understand why the circulation periods for Board papers should be longer than the period required for writing them. That view, however, was not universally shared, including by those Directors who agreed with Mr. Smee that the current guidelines on circulation periods should not be changed.

It was, however, important for the Fund to be seen as responding promptly and immediately to the issues confronting it, the Chairman continued. Therefore, and while recognizing the need to give capitals and Directors as much time as possible to consider staff papers to be brought to the Board, he would suggest that the circulation period for country operations papers should be shortened to ten working days, provided that letters of intent were circulated to Directors beforehand. Article IV consultation papers with large countries would maintain, like policy papers, a three-week circulation period.

Some Directors had suggested that a timely response could be facilitated by a flexible use of waivers, the Chairman recalled. While that was for Directors to decide, he would observe that the practice of waivers posed some difficulties for putting together viable tentative schedules of Board meetings--a task that was, under the best of circumstances, extremely difficult. He would also note that Directors had accepted a general waiver of the circulation periods for the requests of CFAF countries for the use of Fund resources. He hoped that the experience with that procedure would be a positive one and might point to streamlining procedures in the future, not only in the Fund, but also in members' capitals.

Mr. Mirakhor said that he would be interested to know what impact the proposed change was likely to have on the scheduling of items for the agenda.

The Chairman commented that his proposal would not alter the scheduling process, but to the extent that it reduced recourse to waivers, it gave more stability to the tentative schedules circulated to Directors.

Mr. Schoenberg remarked that while he welcomed the Chairman's flexibility on the matter, he was concerned that a period of ten working days might not be sufficient to assess requests for financial assistance, especially on the basis of letters of intent, which tended to be highly technical and legalistic in nature, and without the benefit of an explicit staff assessment.

The Chairman observed that letters of intent contained all critical data and were prepared with the assistance of the Fund staff. While the staff report was of immense value in putting the letter of intent in the perspective of the latest Article IV consultation discussions and the member's past use of Fund resources, he believed that the letter of intent would be sufficient for capitals to take a decision on the merits of the request.

Mr. Zoccali commented that he assumed that country operation papers included reviews of arrangements with the Fund, in which case there might be occasions where the conclusion of a review would be urgent and where there would not be a letter of intent.

The Chairman said that in such instances, waivers might be requested for lengthening the circulation period in the rare event that capitals needed more time to consider the matter.

Mr. Smee stated that he agreed with Mr. Schoenberg on the technical nature of letters of intent, on the need to place them in their proper context, and on the value of the staff's assessment in country authorities' decision making. Moreover, whenever there had been a need to respond quickly to a member's request, the Board had never failed to grant a waiver of the circulation period. He shared the concerns of those Directors who had indicated on other occasions that technological advances had not reached the point where documents could be conveyed rapidly to their capitals. Thus, while he appreciated the Chairman's flexibility in dealing with the question of circulation periods, he saw no reason to change the current guidelines, nor did he consider that the circulation period was responsible for the frequent changes in the Board's schedule of meetings.

The Chairman said that in addition to the stability of the Board schedule, there was another, perhaps more important, concern, namely, to expedite the business of the Fund, particularly when dealing with countries facing severe difficulties and those seeking to build a national consensus for their adjustment policies. In those instances, delays in Fund decision taking were often of immense importance. It was difficult to explain to country authorities that while the staff could complete its report in a week or ten days, it would take three weeks for members' capitals to inform Directors of their views. To address that problem, he would urge Directors to accept a shortening of the circulation period for country operations papers to ten working days when a letter of intent was circulated in advance.

Mr. Fukui remarked that he agreed that there were some limited cases where the staff and the Board had to act exceptionally quickly. But that was not the general rule. Moreover, for his authorities, ten working days was an absolute minimum for sending papers by courier to Tokyo, translating them, and reaching a decision. He would therefore agree that in a limited number of cases, a shortened circulation period would be acceptable. He would prefer, however, to retain the current guidelines, and agree on shortened circulation periods on a case-by-case basis. Moreover, advance circulation of letters of intent could be helpful, but the staff appraisal was an important element in expediting his authorities' consideration of country operations papers.

The Chairman observed that he was not seeking a major change in the Board's practices but rather a limited change that applied only to country operations papers, when they were preceded by a letter of intent. He would therefore urge Directors to accept a shortening of the circulation period for those papers to demonstrate to the membership and to public opinion the importance the Fund attached to dealing expeditiously with the problems of members in difficulty.

Mr. Smee said that while the recognized the need to respond quickly to urgent problems, he agreed with Mr. Fukui that such situations were limited and could be addressed by the expeditious and flexible use of waivers, as had been done recently with the CFAF countries.

Ms. Lissakers stated that she sympathized with the concerns that had been expressed by other Directors. While she took the Chairman's point about the desirability of avoiding repeated waivers and of regularizing the decision-making process and the Board's tentative schedule, as well as the point about the Fund appearing to be responsive to countries that were under tremendous financial pressure in a period of crisis, she believed that if the Board's own review and consideration process was to have any meaning, the Board must be given sufficient time to weigh all the arguments. For her chair, the staff analysis and background information that accompanied a letter of intent were important in the decision-making process. In the present instance, she could defer to those Directors that were far from their capitals and whose authorities' review process involved the translation of documents. She, of course, stood ready to waive the circulation period whenever there was a compelling reason to do so.

Mr. Schoenberg said that he agreed with Ms. Lissakers on the role of the Board. Moreover, while there was concern about the Fund being perceived as a slow-moving bureaucracy, three of the countries that currently had an urgent need for Fund support had been negotiating with the Fund for months, if not for years. He was not convinced that the circulation period was a substantial element in reaching an agreement on a program with a member country.

The Chairman remarked that while it was not a substantial element, at the end of, say, 10 of the 18 program negotiations in which he had participated over the past seven years, the authorities had pressed for an early decision, and he had had to pledge to the country that he would ask the members of the Board for a waiver. In each case, the Board had granted the waiver requested. He would, in the circumstances, prefer to see the exception become the rule.

Mr. Evans observed that the proposal involved operational cases, which were perhaps arguably the more important cases for the Fund. And, as the Chairman had just indicated, in cases where it really mattered, the Board had been prepared to accept a waiver of the circulation period. In his view, there was a balance to be drawn between quick approval of requests by the Board and their proper and full study. On balance, he would be pleased to go along with waivers where they were necessary.

Mr. Havrylyshyn said that he appreciated the flexibility that the Chairman had shown on the matter of circulation periods. He understood that the three-week circulation period would continue for staff papers on Article IV consultations with larger member countries. It was not clear what that implied for other countries.

Many of his constituent countries faced difficult communications problems and limited staffing capacity for the translation and assessment of Fund documents, Mr. Havrylyshyn commented. While they wanted to see the expeditiousness that the Chairman had referred to at all stages, they faced the difficulty of responding in a very short period of time. In that light, a case-by-case approach was probably most appropriate to their circumstances.

The Chairman remarked that he had hoped to make a recommendation concerning the circulation period for consultation papers, but as he did not see much support for changing the current guidelines, he would not broach that subject. He was, of course, disappointed that Directors had not supported his proposal to streamline the Board's procedures, but he noted with satisfaction Directors' readiness to grant waivers as circumstances warranted.

The Executive Directors concluded for the time being their consideration of the circulation periods for Executive Board documents.

5. REPORT BY STAFF

The Director of the Middle Eastern Department said that during the staff's discussions with an Algerian team that had been in Washington for several weeks, the two sides had made solid progress. The immediate and medium-term objectives of an adjustment program, as well as the supportive macroeconomic and structural policies, had been clearly identified by the two sides.

A key objective of the adjustment program under negotiation was to start a process of recovery of domestic economic activity and of employment growth, while at the same time bringing down the rate of inflation firmly after an initial burst on account of price corrections at the outset of the program, the Director stated. In quantified terms, GDP--which had fallen by 2 percent in 1993--was programmed to grow by 3 percent in 1994 and by 6 percent in 1995 and beyond, largely reflecting better capacity use and a recovery in agricultural production, which had been adversely affected by drought in 1993. As indicated by the GDP deflator, inflation, which had averaged 17.5 percent in 1992-93, was to increase to 27 percent in 1994, but thereafter it would trend downward to 18 percent in 1995 and to 6 percent in 1996.

The programmed recovery of economic activity in 1994 and 1995 would inevitably require a substantial increase of imports from the severely compressed levels of recent years in order to restore inventories and obtain needed capital investment and intermediate goods, the Director continued. Imports under the program were forecast to increase to $9.5 billion in 1994, from $7.8 billion in 1993, and to $10.8 billion in 1995, but the rate of increase would slow down markedly thereafter, as the economic reforms took hold and the large investment program in gas development tapered off.

Exports in 1994 were forecast at $8.7 billion, 15 percent lower than in 1993, on account of lower oil prices, but were forecast to increase progressively afterwards to $13.5 billion by 1998. Specifically, the program envisaged a shift in the current account position from a surplus of 2 percent of GDP in 1993 to a deficit of 6.5 percent of GDP in 1994, about $2.4 billion. As to the medium term, the current account deficit was programmed to decline progressively toward balance by 1998. The success of the program would depend on resolute policy actions and their steady implementation, as well as on considerable support from creditors and international financial institutions on a timely basis.

To bring about the above adjustment, the program under negotiation contained four types of policy changes, the Director observed. The first was the broad decontrol of economic activity, trade, and prices. The import system would be fully overhauled through the elimination of the ad hoc committee that allocated foreign exchange for imports as well as the discretionary rules governing imports, such as the "cahier des charges." Under the new system, imports would be classified in three categories: strategic imports, whose importation was allowed by both the private and public sector but subjected to criteria agreed with Fund staff; a small negative list for religious, social, and security reasons; and a third list of products whose import was temporarily suspended, but with a clearly specified calendar for their elimination over a brief period.

In the area of pricing policy, further wide-ranging price liberalization was envisaged with the gradual elimination of administered price fixing, except for three subsidized commodities, the Director continued. As part of the liberalization, substantial adjustments were envisaged under the program in the prices of subsidized commodities, domestic energy, and a number of services. Moreover, the price of fertilizer was to be fully decontrolled at the start of the program. The previous day, the prices of energy products had been increased by 50 percent on average, eliminating any implicit subsidization of most products when calculated at an equilibrium exchange rate. Diesel prices, for instance, had been doubled; fuel oil prices had been raised by 125 percent; and premium gasoline by 30 percent. The new prices of gasoline, fuel oil, and gas oil were currently higher than the economic costs calculated at an equilibrium exchange rate and adding domestic refinery and distribution margins. The increase in energy prices was equivalent to 1.4 percent of GDP on a full-year basis.

The second area of policy change under the program consisted of the introduction of a new exchange system where economic agents would have free access to foreign exchange for most current transactions, the Director explained. In the context of that system, economic policies would need to be managed so that the rate would remain stable at a depreciated level for the first six months of the program; that would be followed by a mechanism where the rate would be set initially through fixing sessions; that system would then be transformed in early 1995 into an interbank market where the rate would be freely determined.

The above policies would be supported by a substantial reduction in the fiscal deficit from 9.3 percent of GDP in 1993 to about 3 percent in 1994 and to surplus in 1995 to be achieved through higher oil receipts, at the depreciated exchange rate, and a number of tax and pricing measures, the Director remarked. A substantial reduction in public investment outlays and in real wages in the public sector was also envisaged under the program. Also, a tight monetary policy and large increases in interest rates would anchor those reforms.

A fourth element of the program was action on the social front, which covered two areas, the Director stated. First, in order to mobilize the necessary backing for the program, there had to be an agreement between the Government and the UGTA--the trade union--on an incomes policy. The Government was confident on reaching such an agreement soon. Second, there had to be actions on the social front, and the program would include concrete steps to that end, aimed at improving the current poorly targeted social safety net arrangements. In particular, a public works program aimed at employing marginal workers was envisaged, as well as the initiation of a funded unemployment benefit system beginning in April 1994.

While the Algerian negotiating team was in broad agreement with the policy strategy that had been outlined, the Government had still to agree to it, and several important elements needed to be specified, the Director commented. In that context, three further points were worth mentioning.

The first was the capacity to implement the program, in view of the current difficult political circumstances, the Director continued. To cope with that issue, many of the above-mentioned steps would be prior actions. Where the phasing in of measures was needed--for instance, in the trade and exchange system areas--a precise timetable of such steps was proposed under the program. Also, most of the measures under the program were relatively straightforward--price adjustments, tax rate changes, and the introduction of transparent and simple systems--while some more complicated reforms, such as the introduction of indirect monetary control instruments, would have to await a follow-on program in 1995, although the staff envisaged technical assistance in the meantime to prepare for their introduction. Moreover, program monitoring and follow-up would be strengthened by having two reviews under the program.

The second point was financing, the Director commented. The program year would run from April 1, 1994 to March 31, 1995. The staff and the authorities had forecast a financing gap for that period of around $6 billion, to which should be added the clearance of payments delays that would have accumulated during the first quarter of calendar 1994, as well as debt service to some non-Paris Club members on which the staff was gathering information. The closing of the gap would need to rely on exceptional financing from international lending institutions, such as the World Bank, the African Development Bank, the Arab Monetary Fund, the European Union, as well as bilateral donors. Most of those institutions had indicated that their funding depended on agreement on a Fund-supported program. In that connection, the authorities were expected to request a stand-by arrangement as well as the use of the compensatory and contingency financing facility. The bulk of the exceptional external assistance would, however, need to come from debt relief from the Paris Club, the London Club, and other creditors.

In considering the current strategy in terms of adjustment and exceptional financing, one important objective was to reduce the current debt-service burden, which currently was equivalent to 90 percent of exports of goods and nonfactor services, the Director stated. The staff hoped that, with agreement on the program outlined above in the near future, the external financing gaps could be closed in 1994 and 1995. However, on the basis of conventional terms for debt relief and new money, the external debt-servicing ratio would remain in a high range of 40 percent to 50 percent of exports over the medium term.

The Algerian negotiating team would be returning to Algiers that evening to brief the authorities on the outline of a possible program that could be supported by the Fund, the Director of the Middle Eastern Department remarked. There were still policy areas where the Algerian authorities' and the staff's positions differed, and others where concrete decisions had to be taken by the Government. Moreover, a consensus needed to be found with the social partners. Thereafter, negotiations with the Fund staff were expected to resume. In the staff's view, the areas of difference could be bridged, but it might take slightly more time than had earlier been expected--say, a few weeks--to reach an agreement. The staff would keep Directors informed of developments in the coming weeks.

The Director of the Western Hemisphere Department stated that for some time the staff had been engaged in discussions with the Brazilian authorities on an economic program that would enable the country to deal effectively with its inflation problem and thus improve its economic performance. The aim had been to develop a program that could be supported by a stand-by arrangement with the Fund and could provide a basis for the conclusion of Brazil's debt package with its commercial bank creditors. The deadlines in regard to the debt package were near at hand, with one deadline only days off and the other in mid-April, when it was hoped that the exchange of debt instruments could take place.

The Brazilian authorities and the staff had been proceeding with considerable care to ensure that the basis was laid for a marked reduction of inflation, the Director continued. It should also be noted that elections would be held in Brazil in October, with a change of administration taking place at the beginning of 1995. Thus, the staff had also been discussing with the authorities how the underpinnings of the program extending into 1995 could be secured.

The staff mission was still in Brasilia, and the discussions on the economic program had registered considerable progress, the Director of the Western Hemisphere Department remarked. The authorities had taken a number of measures on both the revenue and the expenditure side to strengthen the fiscal position and to prepare for deindexation, but further work was still needed. The mission would return to headquarters in the coming days, and a group of Brazilian officials would arrive in Washington at the weekend to continue the discussions.

The Chairman stated that that morning, the Brazilian Finance Minister, Fernando Henrique Cardoso, had called him to confirm the authorities' strong commitment to implementing the measures that had been agreed and ensuring that the program announced was strong and credible. The forthcoming discussions in Washington would be critical to achieving a good-quality program that could receive broad domestic support.

The Director of the Western Hemisphere Department observed that the authorities had taken actions to prepare the grounds for deindexation of the economy. That had perhaps added somewhat to the rate of price increase, although the authorities were also trying to implement a restrictive credit policy to limit the inflationary effects of deindexation. In view of Brazil's past experience with inflation-reduction efforts, the authorities and the staff were particularly mindful of the need to ensure that fiscal policy would make it possible to sustain deindexation. In this regard, Brazil's experience with previous programs had led the authorities to be insistent on avoiding price controls which were not credible to the general public and in fact spurned defensive price increases. They therefore intended to prepare the way for rapid deindexation, but with the emphasis on fiscal and credit policies that were sufficiently strong to hold down inflation.

The Director of the European II Department said that a staff mission had visited Moscow during the period February 1-25 to begin negotiations on a program that could be supported by the second purchase under the systemic transformation facility. Substantive discussions on the quantitative aspects of the program, and in particular on the 1994 budget and on the balance of payments, had begun only toward the end of the visit as the necessary data were not available until that time, and even at the end, not all data were available.

During the course of the mission, the Russian authorities had provided the staff with a Statement of Economic Policies setting out the Government's policies for 1994, the Director remarked. The main features of those policies were a reduction in monthly inflation to 10 percent or less by the end of the year, and commitments to maintain liberal price and exchange rate regimes, to continue with privatization, to maintain the central bank lending rate at market levels, and to move away from directed lending toward allocating credit via the market. The draft federal budget for 1994, which the mission had received at the end of its stay and which the Ministry of Finance had presented to the cabinet the previous week, projected a deficit in the same order of magnitude, in percent of GDP, as had been achieved in 1993.

A staff mission had arrived in Moscow the previous day to resume discussions with the Russian authorities, the Director continued. The mission's work would focus on quantifying the Government's economic program, especially budgetary policy; clarifying the remaining key aspects of economic policy; and obtaining more explicit commitments regarding the content and timing of measures, especially those relating to monetary and fiscal policies, external trade policy, and the strengthening of the social safety net.

Budgetary policy, and supporting credit policies, would need to be at the core of the stabilization program, the Director stated. As to the 1994 budget for the Central Government, the staff had a number of concerns about its implementation. On the revenue side, and taking into account the sharp decline in receipts as a percent of GDP that had taken place over the past six to nine months, the issue was how the authorities' revenue objectives would be met in the absence of any new tax measures. On the expenditure side, the staff would need to be assured that all announced expenditure programs were fully taken into account in the budget--especially as regards wage increases, agricultural subsidies, and support for the Northern Territories--and that the authorities did not intend to make unrealistic use of the cancellation or postponement of authorized expenditures in order to meet their targets. There was a need for budget planning and execution to be carried out in an orderly and predictable fashion, avoiding the accumulation of arrears as occurred in 1993 because fundamental fiscal measures had not been taken. The budget discussions with the staff would therefore focus on assessing the realism of the projections and assumptions underlying the 1994 central government budget. In addition, the staff would assess whether, and to what extent, changes in fiscal federalism arrangements might put additional strains on local government budgets.

Only after a realistic budget for 1994, together with an accompanying credit program, and firm estimates of the balance of payments in 1994 had been discussed with the authorities, would the staff be able to make an assessment of whether the Government's inflation objective for end-1994 was achievable, and whether it was sufficiently ambitious to provide an assurance that irreversible progress would be made toward stabilization, the Director continued. That meant, in practice, that inflation would have to be on a clear downward trend by the end of the year.

The staff would also carefully review with the authorities their policies for accelerating the process of enterprise reform and restructuring, the Director remarked. The experience of the past two years had shown that any concerted effort at bringing inflation under control and implementing sustained reforms in important areas, such as trade policy, could all too easily be undermined by pressures from the enterprise sector. A successful stabilization program must therefore make progress with the difficult question of reforming the enterprise sector, including the implementation of programs for restructuring and rationalization.

In short, the focus of the discussions in the coming days would be on questions relating to the consistency, credibility, and potential for implementation of the economic program as a whole, the Director of the European II Department concluded.

Mr. Evans observed that there had been a number of statements by the Russian Government about the budget deficit, and also about the end-year inflation objective ranging from 3 percent to 5 percent, to the suggestion of a double-figure inflation by the end of the year. According to the staff, the Government's objective for 1994 was to keep the deficit much the same as for 1993, when it had been about 9-10 percent. Some clarification on that point would be helpful.

The Director of the European II Department said that President Yeltsin had indicated that he would like to see inflation reduced to a monthly rate of 3-5 percent by the end of the year. The Government's budget and the preliminary outline of the monetary program implied a monthly inflation rate by the end of the year that was somewhat above that--about 7-9 percent. Further work was needed on the details.

On the federal budget deficit, the figure of 10 percent of GDP was one used by the Government, the Director of the European II Department observed. The concepts used to arrive at that figure were, however, somewhat different from those used by the staff. Using the staff's concepts, the federal budget deficit that was being proposed was about 7-8 percent of GDP, which was similar to the outturn in 1993.

Mr. Waterman recalled that during the previous year, there had been good progress in raising official interest rates to levels close to market rates. He expected that interest rates would achieve market rate levels in the course of 1994, as that was clearly important to the inflation objective for the year.

The Director of the European II Department remarked that since July 1993, the Central Bank's policy had been to keep its finance rate within 7 percentage points of the market rate. It had successfully done that, except for short periods when the rate was considerably above market rates. The authorities had proposed to close that gap to 5 percentage points in 1994. Whether rates were within 5 percentage points or 7 percentage points was not, however, very important when the market rate was a few hundred percent. In that context, what was important was the commitment to maintain the finance rate at market levels, even if lags in the formula for adjusting the rate sometimes resulted in levels that were somewhat above or below the market rate.

Ms. Lissakers commented that in order to assess the likelihood of future budget pressures emanating from the regions and municipalities, it was necessary to have some sense of their revenue position. She wondered whether any data was available on the share of tax revenues remaining with the localities and the share being passed on to the center. Or, had there been a huge drop in overall tax revenue at all levels of government? She would also be interested to know what had been the pattern of credit emissions from the center in the past few months and what had happened to the government arrears that had been built up in the fourth quarter of 1993.

The Director of the European II Department said that the first indications for 1994 suggested that both federal and local government revenues had been low. The system of allocation of revenue between the center and the local was according to several fixed formulas, with different formulas applying to different taxes. The formulas had been changed for 1994 to adjust the share going to the center. The staff's preliminary view was that the change would mean a somewhat reduced share of total revenues going to local governments.

No budgetary arrears had been paid in January, the Director of the European II Department stated. Some had been paid in February, but no figure was as yet available. It was also possible that some new budgetary arrears had been incurred in January. As to credit emissions from the center, there was a ceiling on borrowing by the Government from the Central Bank in the first quarter of 1994. Indications were that the ceiling had not yet been reached, but it might be reached before the end of the quarter, in which case some arrangements would have to be made to provide additional credit from the Central Bank or to find financing.

Mr. Prader observed that there had been a number of press reports over the past months about the change in the Government's position toward reform. He would appreciate the staff's views on whether there had been any change.

The Director of the European II Department said that the new Government had not been in place for very long, and in some respects, its policy views were not yet clear. Having said that, the assurances that the staff had received from the authorities suggested that, on the structural side, their orientation was still very much to move toward the market, and that they had no intention of slowing down the privatization process, although some perhaps favored altering its direction somewhat. Nevertheless, no change had yet formally been made to the existing privatization plan for the year.

The authorities were committed not to introduce price controls in general, but they intended to regulate prices of natural monopolies, which was not a formal part of the policy of the previous Government, the Director commented. They intended to keep the existing unified exchange rate system. They were very concerned about reforming enterprises. There were a number of ideas within the Government about making progress in that area, including possibly closing down some enterprises that were judged not to be viable, partly by way of setting an example to the others.

On balance, the authorities were determined to keep the reform process moving, the Director of the European II Department stated. Its exact speed and shape, however, might be somewhat different than that envisaged by the previous Government, but the direction was clear. The staff would keep Directors informed about significant progress in the ongoing negotiations.

The Executive Directors took note of the reports by the staff.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/94/18 (3/4/94) and EBM/94/19 (3/9/94).

6. ALBANIA - ARTICLE IV CONSULTATION - POSTPONEMENT

Notwithstanding the period of three months specified in Procedure II of the document entitled "Surveillance over Exchange Rate Policies" attached to Decision No. 5392-(77/63), adopted April 29, 1977, as amended, the Executive Board extends the period for completing the next Article IV consultation with Albania to March 28, 1994. (EBD/94/38, 3/1/94)

Decision No. 10609-(94/19), adopted
March 4, 1994

7. REPUBLIC OF POLAND - STAND-BY ARRANGEMENT - EXTENSION

The period of the stand-by arrangement for the Republic of Poland approved on March 8, 1993 is extended to April 8, 1994. (EBS/94/36, 2/28/94)

Decision No. 10610-(94/19), adopted
March 4, 1994

8. ANDORRA - TECHNICAL ASSISTANCE

In response to a request from Andorra for technical assistance, the Executive Board approves the proposal set forth in EBD/94/35 (2/28/94).

Adopted March 4, 1994

9. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 93/91, 93/94, 93/95, 93/135, and 93/136 are approved.

10. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAM/94/12, Supplement 2 (3/4/94) and EBAM/94/33 (3/4/94) and by Advisors to Executive Directors as set forth in EBAM/94/33 (3/4/94) is approved.

APPROVAL: August 29, 1994

LEO VAN HOUTVEN
Secretary