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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 98/4

10:00 a.m., January 12, 1998

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Executive Board Attendance

S. Sugisaki, Acting Chairman

Executive Directors	**Alternate Executive Directors**
A.A. Al-Tuwaijri	S.M. Al-Turki
	R. Fernandez
	C.X. O'Loghlin
	M. Askari-Rankouhi, Temporary
	H. Kaufmann, Temporary
	W.-D. Donecker
	N. Coumbis
	A. Giustiniani, Temporary
D.Z. Guti	
	E. Srejber
	E.M. Carlens, Temporary
	A.L. Coronel, Temporary
W. Kiekens	J. Prader
	B.S. Newman
A. Mirakhor	S. Rouai, Temporary
	A. Vernikov
	J. Shields
A.S. Shaalan	
M.R. Sivaraman	H.B. Disanayaka
G.F. Taylor	
	J. Guzmán-Calafell
J. de Beaufort Wijnholds	
	A. Barro Chambrier
Y. Yoshimura	
	S. Joyosumarto
	Han M.
A.G. Zoccali	

R.H. Munzberg, Secretary
M. J. Miller, Assistant

Income Position for FY 1998—Midyear Review; Rate of Charge as of November 1, 1997; Retroactive Reduction of Rate of Charge for FY 1998 and Increase in Net Income Target for FY 1999; and Charges on Supplemental Reserve Facility
Staff representatives: D. Williams, TRE, Kueppens, TRE; Gianviti, LEG

Also Present
Legal Department: F.P. Gianviti, General Counsel; P. De Boeck, H. Elizalde. Policy Development and Review Department: J.T. Boorman, Director; T. Leddy, Deputy Director; L.D. Dicks-Mireaux, N.L. Happe, K.H. Kang. Secretary's Department: P. Gotur, B.A. Sarr. Treasurer's Department: D. Williams, Treasurer; D. Gupta, Deputy Treasurer; G. Wittich, Deputy Treasurer; G.M. Fitzpatrick, B.E. Keuppens, M.G. Kuhn, B.C.Yuen. Office of the Managing Director: B.A. Christensen; F.J. Gaitan. Advisors to Executive Directors: S.S. Farid, M.F. Melhem, H. Ogushi, Y. Patel. Assistants to Executive Directors: A.S. Alosaimi, M.A. Brooke, M. Budington, D.A.A. Daco, J.P. Leijdekker, D. Merino, L. Palei, L. Pinzani, S. Rouai, O. Schmalzriedt, A.G. Yakub, Zubir bin Abdullah.

1. INCOME POSITION FOR FY 1998—MIDYEAR REVIEW; RATE OF CHARGE AS OF NOVEMBER 1, 1997; RETROACTIVE REDUCTION OF RATE OF CHARGE FOR FY 1998 AND INCREASE IN NET INCOME TARGET FOR FY 1999; AND CHARGES ON SUPPLEMENTAL RESERVE FACILITY

The Executive Directors considered a staff paper on the midyear review of the Fund's income position for FY 1998 (EBS/97/210, 11/24/97). They also had before them a paper on charges on the Supplemental Reserve Facility (EBS/97/234, 12/12/97). They had before them the following statement by the Managing Director:

> The staff's latest update of the Fund's income position for FY 1998 is summarized in the Annex.
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> The total income of the Fund is now projected at SDR 292 million, as compared with a revised projection made in connection with the midyear review of the Fund's income of SDR 152 million. Directors will recall that the net income target for this year is SDR 99 million. The large projected increase in the Fund's income for FY 1998 derives, of course, from the large volume of transactions, especially in light of the Asian crisis and the establishment of the Supplemental Reserve Facility (SRF), which has incorporated in it a surcharge element rising over time from 300 to 500 basis points over the regular rate of charge.
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> As indicated in the table, and for purposes of the January 12 discussion, it might be useful to divide the Fund's income for FY 1998 into two parts, namely (I) income deriving from the use of the Fund's regular facilities, and (ii) income deriving from the SRF. The Executive Board has already decided to reduce retroactively the coefficient of the rate of charge if the Fund's net income is in excess of the target amount. The immediate issue in this connection is whether the Executive Board wishes at this time to reduce the coefficient for FY 1998, as already proposed by the staff, or only for the second half of FY 1998. As regards income under the SRF, the Executive Board agreed to consider the use of such income after the adoption of the Facility and decided that income under the Facility would not be taken into account for the purpose of retroactively reducing the rate of charge for FY 1998 as agreed in the decision on the rate of charge for FY 1998 of April 21, 1997.
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> As regards the **non-SRF income**, the staff's revised projections indicate that the Fund's net income for FY 1998 would amount to SDR 182 million or SDR 83 million in excess of the net income target for FY 1998. (These projections take into account the Fund's actual operations in November and December 1997.) Directors will recall that in the *Midyear Review of the Fund's Income Position for FY 1998* (EBS/97/210), the staff proposed that the Executive Board might wish to consider reducing retroactively the coefficient of the rate of charge from 109.6 percent to 108 percent for FY 1998 including retroactively for the first half of the financial year. Such a reduction would have absorbed about one-half of the projected excess income above the target amount and would have left a safety margin for the remainder of the year in view of possible uncertainties surrounding the staff's projections.

In view of the larger projected net income of SDR 182 million, as compared with SDR 152 million, the coefficient of the rate of charge could be reduced to 107 percent for FY 1998, if again half of the projected excess would be utilized at the present time and half would be kept to the end of the year as a margin of safety to ensure that the target amount of net income would be achieved. I would, therefore, propose that Executive Directors might wish to consider a reduction in the coefficient of the rate of charge to 107 percent for FY 1998, including for the first half of FY 1998 to 107 percent. If the Executive Board agrees with this course of action, Decision I in EBS/97/210 would be adjusted accordingly, and would need to be adopted with a 70 percent majority of the total voting power.

Income from the SRF is projected at SDR 110 million for FY 1998, of which SDR 24 million has already been earned at the end of December as a result of the two transactions under the facility by Korea. It would be useful if Directors could now give guidance as regards the use of this projected income for FY 1998.

You will recall that in the staff paper on *Charges on the Supplemental Reserve Facility* (EBS/97/234), the staff outlined a number of options that could be considered regarding the use of this income, including (I) additional financing of the Fund's precautionary balances; (ii) a retroactive reduction of the basic rate of charge; (iii) suspension or alleviation of burden sharing; and (iv) to meet part of the Fund's administrative and operational expenses, in particular with respect to the financing of the cost of ESAF Trust operations.

In their consideration of the SRF last December, a number of Directors mentioned the possibility of devoting some part of the income deriving from use of the SRF to finance ESAF-HIPC operations. Furthermore, a number of Directors also noted that with the sharp rise in credit outstanding and its increased concentration, consideration might be given to increasing the Fund's precautionary balances.[1] It may be useful to focus our attention today on these two options.

As regards the possible use of part of the SRF income to finance ESAF-HIPC operations, you will recall that the staff proposed in the paper on the *Status Report and Options for Financing the ESAF and the HIPC Initiatives* (EBS/97/210) that the cost to the administrative budget of administering the ESAF Trust could be financed out of the Fund's income rather, as now, from transfers from the ESAF Trust Reserve Account. The staff projects that the cost of conducting ESAF operations will be about SDR 40 million for FY 1998 and such costs are likely to be of the same order

[1]Use of Fund credit is projected to increase to SDR 52.5 billion by the end of this financial year, as compared to projections at the beginning of the year of SDR 34.5 billion, of which the three largest debtors would account for SDR 28.2 billion, or 53.5 percent of total credit outstanding as of April 30, 1998 (as compared with SDR 21.1 billion, or 58.5 percent as of October 1997), while the five largest debtors are projected to account for SDR 37.1 billion, or 70.6 percent as of April 30, 1998, compared with SDR 24.3 billion, or 67 percent as of October 1997.

of magnitude over the next three years or so. Given the amount of SRF income projected for this year, and it can be expected that income under the SRF will be substantial in FY 1999 and FY 2000, it is for consideration that the costs of administering the ESAF Trust be covered for both this year and following years out of the income deriving from operations under the SRF. This could be achieved for FY 1998 by a decision of the Board, taken with an 85 percent majority of the total voting power, and if the Board agreed that a prepayment on future costs would be reasonable, then the consent of each of the creditors to the ESAF would also be required.

I believe there is substantial merit in this scheme, particularly in the light of the difficulties we face in increasing bilateral contributions for providing subsidies in the ESAF-HIPC Trust and the delays in gold sales and the income foregone from investment of such resources.

As regards the possible addition to the Fund's precautionary balances, there is little doubt that with the sharp expansion of and increased concentration in Fund credit, the Fund has increased its exposure to risk. It would, therefore, seem reasonable to add to the Fund's precautionary balances in present circumstances. As pointed out in EBS/97/234 an addition to the Fund's precautionary balances could take the form of a further addition to the Fund's General or Special Reserves or to a special contingent account. Adding to the Fund's reserves would increase the Fund's precautionary balances on a permanent basis. Such an addition could reduce the need for further reserves accumulation in the future when credit outstanding under the SRF had been repaid. Increases in the Fund's precautionary balances through a special contingent account would be temporary. If the Board agreed on a contingent account, it would also need to decide on the distribution of the assets when the account is dissolved after the contingency for which it was established has passed. Balances in such an account (it could either be the SCA-1 or a new SCA-3) would, on dissolution, be returned to the contributing members.[2] In the event that the Board agreed to use the FY 1998 SRF income with respect to the financing of the cost of ESAF Trust operations, we would return to a detailed analysis of the adequacy of the Fund's precautionary balances in April 1998.

In light of the above, I would propose for your consideration that the income from the SRF for FY 1998 be used to meet current and prospective costs incurred by the General Resources Account (GRA) of administering the ESAF Trust, and that the resources that would otherwise be transferred for this purpose from the Special Disbursement Account be transferred to the ESAF-HIPC Trust. If this approach is acceptable, I would further propose for your consideration that we consider the adequacy of the Fund's precautionary

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[2]The transfers to the SCA-1 are financed through the burden-sharing arrangements and are intended to provide against the risk of overdue obligations; the SCA-1 would be dissolved when such overdue obligations are discharged, or earlier if the Executive Board so decides. A new SCA-3 could provide specifically for risk derived from SRF transactions and the account could be dissolved when repurchases have been completed, or earlier if the Executive Board so decides.

balances in April 1998, bearing in mind that income from the SRF could be used to increase the Fund's precautionary balances either by adding it to the Fund's General or Special Reserves or in the form of a transfer to either the SCA-1 or a new SCA-3, which would be returnable to contributors on dissolution. Based on the Board discussion on January 12, the staff could shortly afterwards circulate a decision for Board consideration. We will need to return to these issues in April 1998, when we will set the net income target and also consider the burden-sharing arrangements for FY 1999, as well as decide on the use of income deriving from operations under the SRF.

Ms. Srejber made the following statement:

Against the background that the net income for FY 1998 is likely to be significantly in excess of the target amount, I believe it is reasonable to reduce the rate of charge for the entire FY 1998, as suggested earlier by the staff.

In general, I believe that it is important that the level of the Fund's precautionary balances as a share of outstanding credit remains at a sufficiently high level. This ratio has declined during 1997 and is projected to decline further by the end of FY 1998. In addition, additions to precautionary balances as a proportion of purchases is projected to fall to a record low of 0.9 percent in the coming months. At the same time, the geographical concentration of Fund credit has increased considerably. Consequently, I believe that it would be appropriate to accumulate some excess income above the 5 percent target, and would hence caution against lowering the rate of charge to a lower level than the proposed 107 percent of the SDR rate.

As to the use of the income generated by the Special Reserves Facility (SRF), I agree with the Managing Director that they should not be taken into account when retroactively reducing the rate of charge for FY 1998. Furthermore, the Managing Director presents us with several options for the use of this income. I have earlier opposed the use of GRA resources for the financing of ESAF, including costs incurred by the GRA of administering the ESAF. Although I am aware of the difficulties in raising bilateral contributions for the ESAF-HIPC Trust, and thus have understanding for the Managing Director's proposal to use income from the SRF for FY 1998 to meet current and prospective costs incurred by the GRA of administering the ESAF Trust, I still believe that the idea of using income from the SRF for this purpose is not appropriate, not even during an initial period. Instead, and in line with my reasoning above, I do see several merits in adding the income to the Fund's precautionary balances. Awaiting the review in April, it is better to err on the side of caution and transfer the excess income to the precautionary balances already at this stage.

I would favor that precautionary balances be augmented by the establishment of a new SCA-3, with the accumulated resources returnable when no longer considered needed. The contributors to such a new SCA-3 would be those members borrowing under the SRF. Hence, to make the SCA-3 refundable to the contributors, as suggested by the Managing Director, would according to my understanding effectively mean that the surcharge would be refunded. I could not support that as it would undermine the incentive structure we have tried to establish through the SRF. Instead, in

> order to fully secure that these resources come to the benefit of all us who share the risk with the SRF lending, I am of the view that the refund should be made to all members, for example, according to quota. As I understand the legal situation, the Executive Board decides the conditions for such an SCA account and, hence, it would be possible to introduce some new thinking in its design. I would appreciate the Legal Department looking into this matter with an open mind.

The General Counsel stated that the decisions to be taken by the Executive Board with respect to the Fund's income were subject to a number of principles. While it would be difficult to present an exhaustive list of them at the current juncture, he could say that there was a fundamental distinction between the decisions that related to the determination of net income and the decisions that related to the disposition of that income. In other words, the first step was to determine whether or not such income was net. Only once that determination had been made, could a decision be made with respect to the use of that net income, such as distribution or placement to reserves.

The proposal made by Ms. Srejber hinged on that distinction, the General Counsel considered, and more specifically with the first step, namely the determination of net income. Her proposal would be to have a decision to establish a special contingent account, and the income placed to that special contingent account would, upon repayment by the users of the new supplemental reserve facility, be distributed among the membership on the basis of quota shares. The problem with that proposal was that there was no legal basis for such a decision. Amounts placed to a special contingent account were not part of the Fund's net income. They were set aside to discharge contingent liabilities of the Fund to certain members. In the existing special contingent accounts, the liabilities had been created by decisions of the Fund to return charges paid and remuneration forgone if arrears to the Fund were discharged. Similarly, a new special contingent account could be created by deciding, for instance, that the charges paid by the users of certain resources would be returned to them when they had repaid the Fund. In other words, it was a commitment to reduce the rate of charge, which had been increased temporarily. A temporary reduction in the rate of remuneration, with a later return of the balance of the income foregone, would also impose a liability. The temporary increase in the rate of charge, and the temporary reduction in the rate of remuneration, were the bases for decisions establishing Special Contingent Account 1 (SCA-1) and Special Contingent Account 2 (SCA-2). If the Fund were to set aside a certain amount and place it to an SCA-3, it would be on the basis of the fact that the users of the new supplemental reserve facility were paying a higher rate of charge than they actually should, and that therefore the Fund was prepared to return that increment of the rate of charge. If the SCA approach were used, the proceeds placed into that account could not be distributed on the basis of quotas, but only returned to the contributors.

It was his understanding, however, that Ms. Srejber was really proposing a different scheme, the General Counsel concluded. It was also possible to use a different approach to the determination of the net income. For example, it could be determined by the Fund that the use of Fund resources by a certain member created such a risk that it was probable that the amount would not be returned to the Fund; that was called provisioning. That would be a serious step, particularly if the Fund were to make a determination, at the same time as it was authorizing the use of its resources, that those resources would probably not be repaid, and that a loss would probably be incurred. Provisioning would have implications for the credit rating of the member concerned, as well as for the perception of what the Fund was doing with its resources, but it was legally possible take such a decision and to set aside, on that basis, on amount of Fund income covering the expected loss. Once that amount had been set aside, there were two possibilities. Either the loss materialized, in which case the amount of the provisioning would be used to cover the loss on the Fund's books; or the loss did not materialize, and the amount of the provisioning was reintroduced into the Fund's net income at the time of the repayment. Because at that time the amount of provisioning would be part of current income, it could be used like other income of the Fund, such as for distribution to member countries on the basis of quotas. It appeared that what Ms. Srejber was proposing was neither a placement of reserves, which should be a disposition of net income, nor a special contingent account, but rather a provision for a probable loss.

Mr. Wijnholds commented that it was pitching it very strong to suggest that what Ms. Srejber had proposed was equivalent to provisioning for a presumed loss. In the Netherlands, the bank supervisory practices allowed for dealing with a certain probability that certain loans would not be repaid, and there was a scale of provisioning from that that the commercial banks were expected to make in consequence. He was not sure whether the conclusion could be drawn that an assumption was being made at the outset that a bad loan was in prospect. Certainly, if the provisioning for the loan were set at 80 percent of the loan amount, then clearly the conclusion could be that the loan was bad, but if it were much lower, it was just one way of building in some protection. Perhaps the Board should return to reconsider that rather delicate matter.

It seemed that, from what the General Counsel had said, if the Fund wanted to have some form of protection because of the high risk in some loans that Ms. Srejber and a number of his colleagues perceived, then the special contingent account approach might pose a problem, in the sense that there would be a return to the borrower when the situation changed, Mr. Wijnholds considered. Also, provisioning might have certain implications that the Fund would not want, as the General Counsel had implied. Perhaps the mechanism of adding to the Fund's general reserves would be preferable.

Mr. Newman commented that the General Counsel seemed to be suggesting that additions be made to the general reserve, and that, at some future time, the Board declare a dividend and return the amounts that had been added to all members, in proportion to their quota. Perhaps the General Counsel could describe the decisions that would be required to effect such an approach and the related majority needed in the Board, and the reasons behind them.

Mr. Donecker commented that, as a former central banker, he shared many of the thoughts voiced by Mr. Wijnholds. He would hesitate to declare a new loan to the Fund's biggest debtor as a bad loan right from the beginning and to provision against it. That seemed inappropriate, because there should be a strong expectation that the adjustment program would work and that the debtor would repay the Fund. He wondered whether there were not more ways to deal with the problem than the two that the General Counsel had identified. For example, there must be the possibility of creating a suspense account, into which the additional income from the Supplemental Reserve Facility would be placed. When the loans under that facility were repaid, and thus the risks had disappeared, the Board could decide what to do with the amount in the suspense account; it could be used for a distribution to members, or it could be put in the general reserves. There might be other options as well.

The General Counsel explained that he had attempted to describe the principles that governed the determination of net income, and the extent to which the Fund could exclude certain amounts when determining its net income at the end of the year. There was, as the questions of Messrs. Donecker, Newman, and Wijnholds demonstrated, the possibility of a different approach, which would be to include those additional amounts in the Fund's net income at the end of the year, to place them in the Fund's general reserve, and decide later to distribute the corresponding amounts among the membership on the basis of quotas. A distribution would require a decision of the Executive Board by a 70 percent majority of the total voting power.

A suspense account could be used during the year, but at the end of the year, the Fund's books would have to be closed, and a decision would have to be made as to whether the amount in the suspense account was part of the Fund's income or not, the General Counsel pointed out. That amount could, as Mr. Newman seemed to suggest, be included in the net income and distributed at the present time, which would require only a majority of the votes cast, or it could be placed to the reserves and distributed later. A decision to distribute later would require a 70 percent majority of the total voting power.

Mr. Carlens said that his chair did not have in view any particular solution. He wanted to describe the principles that he believed should govern the use of the income. He saw merit in the ideas of Messrs. Donecker and Newman.

Mr. Mirakhor said that he hoped that the provisioning mechanism was not chosen, and that the word would not get out that the Board might be considering provisioning against loans from the Supplemental Reserve Facility, especially in light of the present wave of downgradings of sovereign debt that was occurring.

Regarding the staff's suggestion to transfer SDR 40 million to the ESAF/HIPC Trust each year until the establishment of the permanent ESAF, it had been his understanding that the Supplemental Reserve Facility was projected to continue only through financial year 2000, Mr. Mirakhor pointed out. In that case, he wondered what would happen between 2000 and 2004.

The Treasurer explained that what the staff was suggesting would amount, in effect, to a prepayment to the ESAF/HIPC Trust. If the sole user—at present—of the Supplemental Reserve Facility completed the repurchases on the expected date, then the last amount of Supplemental Reserve Facility income would come in the year 2000; if the repayment were made on the basis of a repurchase obligation, that repayment would be received in 2001. However, what had been suggested in the Managing Director's statement was the possibility of making prepayments out of the income that would accrue between, say 1998 and 2000 or 2001, which would be kept in the General Resources Account. As the Fund's income would be short, through the continuing period, by the amounts that would need to be reimbursed out of the Special Disbursement Account, that shortfall would carry on and would be taken into account in the determination of net income in subsequent years, for as long as the Board would wish that technique to be applied.

Mr. Shaalan made the following statement:

> The review of the Fund's income position indicated in the various papers before us indicates that net income for FY 1998 is now projected to be SDR 182 million, a figure that exceeds the target by some SDR 83 million. We are of the view that, in line with the Board decision of April 1997, this excess should be used to reduce the rate of charge retroactively. Accordingly, we can support decision 1, as adjusted in the Managing Director's statement.
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> With regard to the more difficult issue of the income from the Supplemental Reserve Facility, we believe in the basic premise, namely, that

the sharp expansion and concentration of Fund credit has increased the Fund's exposure to risk. That being the case, we cannot altogether agree with the Managing Director's proposal to use the totality of the proceeds of the income from the Supplemental Reserve Facility in FY 1998 to finance the ESAF-HIPC Initiative. These monies should, in the first instance, be directed to increasing the Fund's precautionary balances to a reasonable level that would take account of the risks I just referred to. I am not sure how it is going to be done, or by how much we need to increase the precautionary balances, but once we are satisfied that we are addressing this problem, then monies can be diverted to the ESAF-HIPC Initiative. Our concern is, of course, that failure to accumulate adequate precautionary balances with the present income stream from the Supplemental Reserve Facility could necessitate raising the income target down the road for that purpose. This would place an unfair burden on debtor countries and would, in fact, produce the perverse result of having developing countries bear the burden of financing the poorer ESAF-HIPC countries.

As to where to place the proceeds, we remain undecided on the question of whether these proceeds should go to the reserve account or to a separate SCA-3 account. However, at this stage, I will have to admit that we favor the reserve option, since we would avoid the complex issues associated with the refunding of these amounts to contributors when they are no longer needed. Placing these funds in reserves would increase the precautionary balances on a permanent basis, and could reduce the need for further reserve accumulation in the future, when credit outstanding under the Supplemental Reserve Facility had been repaid, or, as Mr. Newman pointed out, it could be returned to the membership in relation to their quotas in the form of a dividend. Having said that, we remain open to hearing different points of view and suggestions before taking a final position on this issue.

Mr. Newman made the following statement:

The recent expansion of the Fund lending and establishment of the Supplemental Reserve Facility has produced a substantial increase in Fund income amounting to SDR 193 million in excess of the net income target, including SDR 83 million from regular operations and SDR 110 million from the SRF. A good case can be made that the entire SDR 193 million should be added to the Fund's precautionary balances due to increased risk exposure and the deterioration in the traditional reserve ratios. However, we believe that the short-term nature of SRF operations and the prospect of further substantial surplus income over the next few years provides some room for flexibility.

In these circumstances, we have some sympathy for the general approach proposed by the Managing Director although are concerned that it provides for no increase in precautionary balances during the current financial year. The bulk of the increase in the Fund's exposure this year reflects Stand-By and Extended Arrangements rather than the SRF and some increase in the net income target and/or burden-sharing arrangements would be warranted to finance an increase in precautionary balances. However, we recognize that the current decision on charges was painstakingly negotiated and cannot be modified easily despite the material change in circumstances. Therefore, we would be prepared to accept reluctantly a retroactive refund of the full SDR 83 million in surplus income from regular operations through a reduction of the rate charge either now or at the end of the financial year. However, this experience indicates that a review of the Fund's policy on the size of and addition to its precautionary balances is warranted, including whether it is prudent to preclude an increase in these balances during the financial year when a substantial increase in the Fund's risk exposure occurs.

The SDR 110 million in SRF income during the current financial year represents a down payment on what is likely to be a large, albeit uncertain, increase in revenue over the next few years, both in absolute amounts and relative to the free reserve ratio of 3–5 percent of outstanding SRF loans. In view of the financial constraints facing ESAF and the HIPC initiative, a use of a portion of the SRF income to finance reimbursement of the Fund's expense of administering ESAF is reasonable. The Managing Director's proposal to prefinance several years of reimbursement represents, in effect, a capitalization of future ESAF contingent liabilities which retains the resource stream in ESAF while using other funds to offset the adverse impact on the Fund's net income and thus charges. We would also agree that uncertainties regarding SRF income and the amount of administrative reimbursement indicates that the amount of capitalization should be limited to a few years and determined in large measure by the SRF income available. However, this approach could be reviewed each year as estimates of SRF income become firmer.

Nevertheless, we are concerned that no increase in reserves is contemplated at this time despite the sharp increase in Fund lending. We appreciate management's proposal to review the adequacy of the Fund's precautionary balances in April but believe that prudence requires some greater assurance that some increase will actually occur. This could be accomplished by placing a small portion of the current SRF income in precautionary balances now or by a clear indication in our decision today that the balances will be increased as part of the April review.

Finally, we believe that additions to precautionary balances from SRF income should be placed in the general reserve rather than existing or new special contingency accounts. In establishing the SRF, the Board agreed that the resulting income would not be used to meet the Fund's net income target for the purpose of determining the rate of charge. Similarly, we do not believe that SRF borrowers should receive a retroactive reduction in charges which would also undermine the effectiveness and purpose of the surcharge as an incentive to early repayment.

Mr. Sivaraman made the following statement:

I would like to thank the Managing Director for his very useful statement, which contains a number of interesting suggestions. The use of the additional income from the SRF could either be correlated with the objective for which it was set up, or dealt with separately on its own. The objective of setting up the facility was to deal exclusively with short-term crises where exceptional access to Fund resources was considered necessary. The Fund is, at times, providing amounts to countries with little relationship to the size of quota, it has the strong belief that the countries receiving the assistance under that facility would be sufficiently strong to repay the Fund in good time after the crisis. At the same time, it would be imprudent to discount the factor that is inherent in such a facility. I agree with the other Directors that it may not be wise to provision, as that would send the wrong signal.

However, one could take the view that the entire additional income arising out of the Supplemental Reserve Facility could be kept in the Fund's precautionary balances or general reserves. While this would strengthen the Fund's reserve position, the question would arise as to what extent the Fund's reserve position should be strengthened. The staff has not indicated whether there are any means of judging an optimal reserve position. The proportion of free reserves to credit outstanding has declined. I would not, however, subscribe to the suggestion that the additional income derived from the use of the credit under the Supplemental Reserve Facility should be applied to a retroactive reduction in the basic rate of charge. In my view, this would be improper, if not immoral, as it would be tantamount to using income deriving from the distressed situation of a country for the benefit of all the members. Currently, members are bearing the burden of overdue obligations on the Fund's financial position. The Fund is also looking to augment its resources in order to meet the commitments under the ESAF-HIPC Initiative. The Board of Governors of the Fund has been unanimous in supporting that Initiative.

I very much like the idea of Mr. Donecker that we could think in terms of creating a suspense account. Suspense accounts are created in the budget at times when no decision has been taken as to what is to be done with an amount. Of course, as the General Counsel said, we may have to close the account at the end of the financial year, but we should be able to decide as to the disposition of that income within the year. It is only for the purpose of giving time to the Board to decide on what is to be done with the amount. I would be willing to support the additional income being used to partly reduce the burden-sharing obligations, and to reimbursing the GRA for the cost of operating the ESAF/HIPC Trust. If there is no consensus on this, however, I am willing to support the entire amount being kept in any reserve that can be used later. I do not support Ms. Srejber's idea distributing this amount among members on the basis of quota, for the reasons I mentioned earlier.

As regards the normal income of the Fund, I could have accepted the suggestion contained in paragraph 26 of EBS/97/210, but now that the Managing Director has made a slight change to it, I would like to support the suggestion contained in the Managing Director's statement in paragraph 5.

Mr. Guzmán-Calafell made the following statement:

According to the latest projections, Fund's nonSRF net income for financial year 1988 will amount to 182 million SDR's, or 83 million SDR's above the target established in April 1997. Under these circumstances, it is proposed to reduce the charges coefficient for financial year 1998 and to refund promptly excess charges paid for the first two quarters of the financial year. This is indeed reasonable. With nonSRF net income results projected at levels more than 80 percent above the goals set, the existence of wide margins to reduce at this stage the coefficient of the rate of charge should not be the subject of much discussion. Given a number of uncertainties regarding the behavior of factors that could affect the Fund's income, the Managing Director suggests decreasing the charges coefficient so as to attain an excess income of about half the amount projected. While the margins of safety provided by this approach would seem to be large, I agree that it is better to be prudent and therefore I support this proposal.

On the use of income originating from the creation of the SRF, I would make the following comments.

First, one of the main arguments used by the staff to justify the existence of higher charges under the SRF was to cover the Fund against the "additional exposure to risk that would accompany large scale and frontloaded use of Fund resources." It is not difficult to conclude, therefore, that in considering the utilization of income from the SRF our main priority should be to increase the level of the Fund's precautionary balances. In fact, we should follow the staff's advise in paper EBS/97/234 that pending the next review of the adequacy of the Fund's precautionary balances, "the Executive Board may wish to reserve judgment on the use of the net income that derives from the use of credit under the SRF."

Second, among the options put forward in the Managing Director's statement regarding an addition to the Fund's precautionary balances, in principle I would favor the creation of a special contingent account with balances returned to the contributing members once the account is dissolved.

Third, like Ms. Srejber, I do not support use of income from the SRF to meet costs incurred by the General Resources Account of administering the ESAF Trust. The search for ways to finance the ESAF-HIPC Trust is well appreciated. However, the use of income from the SRF is not an adequate means to achieve this objective, since it may discourage bilateral contributions and gives rise to significant uncertainties on burden sharing in the financing of the Trust. On the other hand, it is surprising that we are asked to agree on this before assessing the need for additional precautionary balances.

Fourth, any income from the SRF not used for the creation of reserves or reimbursed to users of this facility if the creation of a special contingency account is not supported by the Board, should be destined to alleviate the burden on creditors and debtors under the burden-sharing arrangements. In deciding who should benefit form the allocation of this income, we must bear in mind that not all member countries contribute to finance the costs resulting from the persistence of overdue financial obligations at the Fund. I do not understand the reasons why this option was discarded in the Managing Director's statement and I would welcome the staff's comments on this.

Fifth, paragraph 3 in the Managing Director's statement states that the Board has already decided that income under the Facility would not be taken into account for the purpose of retroactively reducing the rate of charge for FY 1998. The staff may wish to correct me if I am mistaken, but my understanding is that no decision in this regard has been taken. As I understand it, the only agreement so far is not to use income from the SRF to reduce retroactively the rate of charge until we decide what to do with this income. In other words, it is still for the Board to determine whether this income can be used in full or in part to reduce the rate of charge in financial year 1998. It is worth noting in this regard that in paper EBS/97/234 the staff notes that since "the negotiation of programs and the extension of credits under the SRF adds to administrative expenses, . . . it would seem reasonable that at least part of the additional income . . . would enter into the calculation of the basic rate of charge." I fully agree with this staff's proposal and I believe it would be useful to hear their views on this.

The Treasurer confirmed Mr. Guzmán-Calafell's understanding that the decision taken in December 1997 on the Supplemental Reserve Facility was that not all the income deriving from use of resources under that facility would be taken into account for the purposes of automatically reducing the rate of charge for FY 1998. As the income could not remain unused or unattributed at the end of the year, that income would have to be placed somewhere. It had been left for the Board to decide at a subsequent date what to do with that income. Among those options, the Board could decide to use part of the income for a retroactive reduction in the rate of charge but, under the terms of the decision, that could not be done automatically. The Board had left its hands untied with regard to the use of that income.

Mr. Giustiniani made the following statement:

When we reviewed the Fund's income position for the financial year 1998, in April 1997, we could hardly foresee the dramatic change in the economic environment that materialized in the following months.

In taking our decision today, we should always bear in mind a couple of figures. In April 1997, GRA credit outstanding at the end of the current financial year was projected to reach about SDR 37 billion and the precautionary balances were expected to correspond to 10.4 percent of that amount, in line with their average level in the 1993-1997 period. In the latest staff projections, while the Fund credit outstanding is estimated to soar to above SDR 52 billion, with an increase of about 40 percent with respect to original estimates, the precautionary balances, as a proportion of total credit outstanding, are expected to fall to around 7.5 percent. If we wanted to bring the precautionary balances as a proportion of the outstanding credit back in line with the original projections, according to back-of-the-envelope calculations, we should increase these balances by SDR 1.5 billion. If we deemed it appropriate to reach just a ratio of 9 percent (equal to the average between 10.4 and 7.6 percent), the additional financing of the Fund's precautionary balances should amount to SDR 758 million.

Let us now turn to the staff's latest update of the Fund's income position. According to these revised projections, in the FY 1998 the Fund is expected to record an "excess net income" of SDR 193 million. Technically, we are correct in considering this amount of income as in excess of our original projections, but practically we are wrong; we are misinterpreting the situation. We cannot consider this income as a windfall gain, ready to be distributed: part to reduce the rate of charge, part to finance the ESAF-HIPC and so forth. In doing so, we would not give adequate consideration to the material change in the economic environment that has occurred, to the higher financial risk that this Institution is bearing given the sharp increase in the credit outstanding, in its concentration, and in the number of countries with an access well beyond the usual limits. As we well know, reserves are maintained to protect the

Fund's assets from impairment and to indicate a sound financial management of assets.

Therefore, in order to maintain the financial soundness of this Institution, we should reconsider the decision taken last April. In light of the higher risks assumed by the Fund, we should devote the whole amount of income in excess of the established target to increase the Fund's precautionary balances. I believe that this would represent the best strategy we could follow. In addition, we should bear in mind that even in this rosiest scenario the Fund's reserves would barely reach the level of 8 percent of the Fund's outstanding credit, thus remaining well below their average. In the event that at a later date we should deem excessive the level of Fund reserves, we could always, if I interpret Article XII, Section 6 (d) correctly, "decide ... to distribute any part of the general reserves to all members in proportion to their quotas."

But, since this option of sound financial administration does not seem to gather adequate support, I certainly consider it appropriate to maintain the two sources of "excess income" separate, namely the income deriving from the use of the Fund's regular facility and that deriving from the Supplemental Reserve Facility. While in the former case, though reluctantly, I can go along with the option of devoting part—but not more than half—of the **non-SRF income** to reducing the rate of charge, in the latter case I cannot support the Managing Director's proposal to use part of the SRF income to finance the ESAF-HIPC initiative. This is for two reasons: first, because this proposal further reduces the adequacy of precautionary balances; second, the Board has already agreed to transfer sufficient resources from the Reserve Account to the ESAF-HIPC account such as to finance expected commitments. Today, in his statement, the Managing Director proposes to consider the adequacy of the Fund's precautionary balance in April 1998, but before such an analysis is undertaken he seems to have already reached the conclusion that Fund's reserves are adequate and therefore part of them can be used to finance ESAF-HIPC operations. At the present juncture, I believe it would be more appropriate to return to this issue only after the review of the adequacy of the Fund's precautionary balances is concluded. In that occasion, adequate consideration should also be given to the possibility of using the income deriving from the SRF to reconsider the current policy of burden sharing.

Finally, as far as the issue of whether the additional financing of the Fund's precautionary balances should be through an increase in the Fund's General or Special Reserves or a SCA-3, my first thought would be to support the first option. It seems to be the simplest procedure. However, I am ready to consider alternative approaches provided that they fulfill the general principles underscored by Mrs. Srejber in her statement.

Responding to a question from the Acting Chairman, Mr. Giustiniani confirmed that his favorite option was to revise the April 1997 decision, and to place all the income to the Fund's reserves.

Mr. Askari-Rankouhi wondered what majority in the Board would be required to change the net income target.

Mr. Donecker recalled that, at the time the decision on the net income target for the current financial year was taken in April 1997, the expectation had been that the amount of income in excess of the Fund's net income target would amount to some SDR 10–15 million. In view of the dramatic change in the expectations about the net income that the creation of the Supplemental Reserve Facility had caused, the basis for that decision no longer existed there. Perhaps a consensus could be reached on a somewhat different distribution of the net income: one half of the amount of the excess of SDR 83 million might be applied to a retroactive reduction in the rate of charge, with the other half being placed to the Fund's general reserves. That would seem to be a sensible compromise.

The General Counsel stated that, with respect to the question of the majority required to change the decision on the net income target for FY 1998, given the existing decisions that linked the net income target to the amount of charges to be paid by the debtors, and the refundability of those charges, a 70 percent majority of the total voting power would be required. With respect to the majority required to amend the decision of the preceding year on the refundability of the rate of charge, any decision that would affect the rate of charge required a 70 percent majority; but in addition, that decision had been in effect for about eight months, and a certain amount of income had accrued over that period, which created a vested right for the payers of charges to a refund of the corresponding income, to the extent that the net income target would be met or exceeded at the end of the year. Therefore, the decision to amend the decision of the preceding year on the refundability of the rate of charge could be made only prospectively; thus, it would apply only to income accrued after the date of the new decision.

Mr. Donecker said that it was not clear to why the Board could not, on a unanimous basis, decide on a different distribution of income, and thus correct the old decision in that respect.

The General Counsel replied that it needed to be borne in mind that an entitlement of member countries had arisen as a result of the April decision. The consent of the debtors to forgo the refundability of the charges—to which they were entitled—would need to be secured. Agreement from each of the debtors would be needed; a Board decision would not be enough.

Messrs. Barro Chambrier, Guzmán-Calafell, Shaalan, and Vernikov stated that they would oppose any change in what the Board had agreed in April 1997.

Mr. Askari-Rankouhi wondered what part of the SDR 83 million had already been accrued, and what part would be due from the present until the end of April 1998.

The Treasurer explained that if end-January were the cut-off point for prospective changes in income, about SDR 132 million had already accrued to the Fund. That would leave about SDR 50 million to come between February 1 and April 30. It was with regard to the distribution of the latter part, as the General Counsel had pointed out, that the Board could consider changing the decision of April 1997, by a 70 percent majority of the voting power in the Board. A change in the distribution of the former part—the SDR 132 million—would require in addition the consent of all the debtors who had paid charges in that period.

The General Counsel, responding to a question from Mr. Newman, said that the decision taken at the time the SRF was established, with respect to the revenues from the use of Supplemental Reserve Facility resources, was that none of those revenues would be used for purposes of the automatic reduction in the rate of charge that had been decided in

April 1977. It was still possible for the Board to decide, with respect to the corresponding amounts, what to do with them. The Board could, by a 70 percent majority, take a new decision to use the corresponding amounts for a further reduction in the rate of charge. A new decision to place the corresponding amounts to reserves, or to distribute the net income to member countries, would require only a majority of the votes cast.

Mr. Newman wondered why a decision to reduce retroactively the rate of charge would require a 70 percent majority rather than an 85 percent majority, taking into account the fact that the initial decision not to include revenues from use of the Supplemental Reserve Account to reduce charges had been part of the decision on the Supplemental Reserve Facility itself, which had required an 85 percent majority.

The General Counsel replied that an 85 percent majority had been required for the decision on the Supplemental Reserve Facility because other features of that facility had required an 85 percent majority. Whenever a decision included several elements, some of which required different majorities, the highest majority was needed for the adoption of the decision. The part of the decision concerning the rate of charge only required a 70 percent majority.

Mrs. Coronel made the following statement:

> First, regarding the destination of income deriving from the use of the Fund's regular facilities, we support Decision I, as adjusted according to the latest projections contemplated in the Statement of the Managing Director (BUFF/98/1 of January 8, 1998). This would involve a retroactive reduction of the coefficient of the rate of charge from 109.6 to 107.0 percent of the SDR interest rate for the first half of the financial year, and would reduce in the same amount the coefficient for the period starting November 1, 1997.
>
> The coefficient of 107.0 percent involves a conservative approach, since it is based on an estimation of excess income equivalent to only half the amount technically projected by the staff for FY 1998. Therefore, it allows for a prudent margin of safety. In fact, it is highly probable that another downward adjustment would be needed after the end of the financial year, in line with the Board's resolution to proceed automatically with a retroactive reduction of the rate of charge, in the presence of excess income, which we are not willing to modify.
>
> Second, regarding income from the Supplemental Reserve Facility, like Mr. Guzmán-Calafell we believe that one option that should be considered is the use of that income in full or in part for the purpose of retroactively and additionally reducing the rate of charge for FY 1998. If this alternative is not acceptable for the Board, we would favor the review of the adequacy of the Fund's precautionary balances in April; and, once the need to increase them is quantified, income from the Supplemental Reserve Facility could be devoted to a contingency account, preferably a new one. This account would be dissolved when all or most repurchases have been completed, and on dissolution, income would be returned to contributors.

Mr. Al-Tuwaijri made the following statement:

The Fund's income position for the current financial year is now expected to be almost three times the targeted amount. Indeed, Fund's income has already exceeded the targeted amount for the whole year. This development reflects mainly a much higher than expected increase in demand on Fund resources, and purchases under the Supplemental Reserve Facility. Even after excluding income from the SRF the Fund's income position is now expected to be SDR 83 million higher than the targeted amount.

Under these circumstances, I support management's proposal to reduce the charges coefficient to 107 percent of the SDR interest rate and to promptly refund excess charges paid for the first two quarters of the financial year.

On the use of proceeds from the SRF, I can support management's proposal that part of the proceeds be used to cover the cost at the administrative budget of administering the ESAF Trust. The remaining proceeds should go to the general reserves with the provision that the proceeds will be reimbursed to the membership once the loans under the SRF are repaid.

Mr. Vernikov made the following statement:

The main difference between the income derived from the Supplemental Reserve Facility and income from other Fund facilities is the surcharge. Therefore, I do not see why the service charges and the margin on use of Fund credit should be excluded from the Fund's income. Indeed, in the absence of the new facility, such income would certainly be inseparable from other similar income. In my opinion, projected net income from regular facilities, in the amount of SDR 182 million and identical in nature to income from the SRF, projected in the amount of SDR 44 million, should be treated on the basis of the Fund's standard practice.

I agree with the staff proposal to a apply new reduced coefficient of the rate of charge for FY 1998 including retroactively for the first half of the financial year. I support the proposal by the Managing Director regarding the decrease in the coefficient and consider it important that we respect Executive Board Decision No. 11482 (97/42) of April 21, 1997.

I think it would be sensible to refund promptly excess charges paid for the first two quarters of the financial year, as it is proposed by Decision I. At the end of the 1998 financial year, we should go through this exercise again and retroactively dispense realized extra income.

In my opinion, the only new problem we are facing today is the use of a very large additional income derived from the surcharge.

As for the proposed uses for the extra income, I share the opinion of those members of the Board who favor using the additional income to finance burden sharing. This option was included in the paper on charges on SRF and supported by several chairs. I am surprised that it has been omitted.

I reserve my final view on the use of the income from SRF surcharges for financing of ESAF-HIPC until a later stage in this discussion. At the same time, I note that by using income for this purpose we would indirectly reward countries that delayed their bilateral contributions and penalize those who came forward.

Like other directors, I see the need to strengthen the precautionary balances of the Fund. The choice of an appropriate form to do that is not straightforward. Our experience with the SCA-2 shows that the process of liquidation of such accounts is lengthy and cumbersome. I would need to better understand the envisaged modalities of a new account to decide if it is preferable to the use of the income from surcharges for the general reserves of the Fund.

Mr. Askari-Rankouhi made the following statement:

With regard to the SRF income, this chair's position is well known. We attach very high priority to maximizing the resources available to the ESAF-HIPC Trust. We could therefore accept the Managing Director's proposal to use this year's SRF income of SDR 110 million to prepay the future cost of administering the ESAF Trust. However, this should not set any precedents or prejudice the Board's future decision on the use of the SRF income.

As regards the **non-SRF income**, I note that the use of Fund resources has sharply increased since last April, when the net income target was set. Moreover, a large part of Fund credit is now concentrated in a troubled region, raising the exposure to risk. These developments point to the need for permanently higher precautionary balances. We should also be concerned that continued and substantial reductions in the coefficient of the rate of charge could jeopardize the financial stability and viability of the Fund.

We would therefore propose that the net income target for FY 1998 be raised in order to allocate more funds to the general reserve. However, in the spirit of compromise, this chair could consider using half of the projected excess net income—that is, about SDR 41 million—for reducing the rate of charge for this financial year, and the other half for increasing the net income target.

Mr. Zoccali made the following statement:

I can be brief.

The estimated "regular" Fund income of SDR 182 represents almost twice the targeted net income for FY 1998 and would allow for a reduction in the coefficient in the rate of charge to below 106 percent while still providing a very comfortable margin to guarantee attainment of the 5 percent addition to reserves agreed for FY 1998.

In the current circumstances, however, we would support Decision 1 as adjusted by the new figures in the Managing Director's statement, i.e. to set the coefficient of the rate of charge at 107 for FY 1998.

Regarding the use of income from the SRF, which is projected at SDR 110 million for FY 1998, we were somewhat puzzled by the fact that utilization of income in management's proposal was not fully devoted to increasing precautionary balances and that in establishing an alternative use, no part of the proceeds of the service charge and the margin between the rate of remuneration and the basic rate of charge was devoted to defraying the additional administrative expenses associated with the actual use of Fund resources under SRF. In this regard, the position of this chair is similar to that of Ms. Coronel and Mr. Guzmán-Calafell.

With respect to the appropriateness of using SRF income for FY 1998 to meet the current and prospective expenses by the GRA of administering the ESAF Trust, our views coincide with those of Mr. Vernikov and others. Moreover, it should be recognized that a significant portion of confirmed pledges to finance the subsidy element of the ESAF/HIPC Initiative already comes from developing countries, many of which are also Fund borrowers. Using SRF income for this purpose would unduly increase the burden of their participation and change the intended widespread character of contributions.

Mr. Shields made the following statement:

We are in a difficult position about the net income target for the current financial year. It seems an anomaly that net income is considerably above what we expected, largely because the Fund has been more active than expected. Therefore, its risks have increased. In normal circumstances, one would expect some of that net income to be retained in precautionary balances against the increased risk. At the same time, we are bound by decisions taken earlier in the year.

Some of the compromises suggested by my colleagues—Mr. Giustiniani and Mr. Askari-Rankouhi—looked reasonable to try to find some way of balancing both the commitments that have been made to debtors and the need to cover the increased risk and the increased liabilities. There may be a way of doing that in looking at the net income remaining for the rest of this year. I would be sympathetic to that, but I also well understand that, if debtors believe that commitments have been made, it is difficult for this Board to go against that.

Regarding future years and the distribution of the additional income from the SRF, that facility is obviously different from stand-by and Extended Arrangements. SRF purchases constitute fairly short-term risks to the Fund, and it may well be that our way of addressing those risks should be different, although I do not know quite how to take that into account. However, it would seem reasonable to make most of that income available for other uses, in particular for the requirements of the ESAF-HIPC Initiative. I liked the ideas in the Managing Director's statement to use this income this year, and part of the income in future years, to prepay administrative costs incurred by the ESAF Trust. If there is additional income in future years, and some of that goes to reserves to balance against the risks, then some sort of suspense account would be appropriate. Those amounts would be a dedicated part of the reserves and could be distributed at a later date.

Mr. Donecker made the following statement:

Our discussion today on the Fund's midyear income position is not only about various alternatives for putting the excess net income received so far, or estimated for the rest of this financial year, to good use, but also about fairness in dealing with each other in this extremely important multilateral institution. Thus, it is also about strengthening rather than weakening the cooperative spirit on which the Fund is based and on which the Fund is critically dependent. Our recent emergency packages for several Southeast Asian members have underlined the importance of that aspect once again.

We need to look at the issues before us today with an open mind, not from a narrow national angle, and in a cooperative spirit. We should aim to reach consensus decisions on the use of excess net income, as well as on the use of income deriving from the SRF, that protect and further the interests of all Fund members. For this reason, it appears appropriate and helpful to clearly differentiate between, first, the already realized or expected excess net income during the current financial year deriving from regular Fund operations and transactions, on the one hand, and, second, the special income arising out of the operation of the SRF, on the other hand.

With regard to the policy options on the distribution of the total estimated excess income arising out of the Fund's regular business operations, I should like to remind the Board that the foundation of our burden sharing and charges decisions of last April was eroded by unexpected events, such as the extraordinarily large Fund programs for Thailand and Indonesia. When taking those decisions, clearly, none of us expected these crises to break out during the current financial year, and none of us expected the related windfall excess income. Instead of initially projected service charges of SDR 30 million for FY 1998, the staff now predicts service charge income to be SDR 75 million; that is, a windfall income of SDR 45 million in this area alone, due mainly to the exceptionally large credits to Indonesia and Thailand, not counting additional service charge income arising out of the SRF operations.

Against this background, and in view of the obvious fact that this windfall of SDR 45 million is directly related to correspondingly large increases in Fund lending risks, it would only seem fair and, in our view, clearly advisable, to transfer this windfall of SDR 45 million, or at least half of the total expected SDR 83 million excess, to the Fund's general reserves at the end of the current financial year. In proposing this, I am fully aware of the position of our Legal Department that on legal grounds alone, our debtor members can demand that the full amount of regular excess income be used to reduce the rate of charge retroactively for this current year, since we failed to establish a ceiling for the use of excess net income for that purpose last April. But would such insistence on legal rights properly reflect the cooperative spirit in which those burden-sharing decisions were taken last April? Certainly not. I have been dealing with these income target, excess income distribution, and burden-sharing issues on the side of my authorities long enough to be sure about that. Nothing says that this Board cannot take a consensus decision, after making contact with one's home authorities, to allocate at least half of that expected excess income of SDR 83 million to the Fund's general reserves, and to use the other half for a retroactive reduction of the rate of charge, without setting a precedent in view of the exceptional circumstances. In this context, we would be willing to support the staff's earlier proposal to retroactively reduce the coefficient of the rate of charge from to 106 percent from 108 percent for FY 1998, including retroactively for the first half of the current year. I note that several Directors, like Mr. Shaalan, have said that they cannot, at least at the moment, accept a consensus decision, but there is still time to reconsider this issue. If the debtor countries demand that we stick to this decision of last April, in spite of the drastic changes, we will honor this decision.

Concerning the disposition of the estimated special income from SRF operations at the end of FY 1998, in view of the fact that all of this income is derived from the Fund's willingness to incur particularly large lending risks to assist members that qualify for such extraordinarily large Fund assistance, we would prefer to allocate most of the special income to the general reserves. On a personal basis, I find Ms. Srejber's suggestion of distributing a part of the special income at a later stage to all members on the basis of Fund quotas, once its lending has been repaid, an interesting alternative worth further study. Nevertheless, my authorities will surely want to reflect further on this, in light of our discussion on this and other proposals, before reaching a judgment. However, we certainly would not want to establish yet another special contingent account for that purpose, in order to avoid any misconception that these funds would be refundable to any SRF borrowers. However, having said this, in the spirit of compromise, we, like other speakers, are willing to accept using SDR 40 million of that special SRF income in FY 1998 to finance the cost to the administrative budget of administering the ESAF Trust, and thus, for the benefit of a large number of low-income Fund members.

We would prefer to allocate the remaining SRF income for FY 1998 to the Fund's general reserves, but this decision need not be taken now. Also, a decision to use part of this SRF income for a reduction of our burden-sharing operations can wait until April 1998, and taken up in the context of our upcoming discussions on the net income target and the precautionary balance targets for FY 1999. In this context, we need to remain aware of the fact that the envisaged refund of SCA-2 holdings—primarily for the benefit of the ESAF—will reduce the Fund's precautionary balances by SDR 1 billion at a time of a steep increase in Fund lending to a few borrowers. We will have to come back to these issues soon.

Mrs. Guti made the following statement:

According to the most recent information provided by the staff, the revised projections for FY 1998 now estimate that the Fund's net income will surpass the target amount by 84 percent.

These favorable developments in the Fund's income position argue strongly in favor of the staff's recommendation to reduce the coefficient of the rate of charge to the SDR interest rate for the entire financial year, with the implicit immediate restitution of excess charges for the first half of the year. However, while we agree with the staff that the net income estimates for the remainder of the financial year are still subject to unpredictable developments, we believe that lowering the coefficient to the 107 percent as proposed, will not impose any serious risks on the attainment of the net income target.

Regarding the use of the income generated under the Supplemental Reserve Facility during FY 1998 the Board has already taken a decision to exclude this income from being applied to reducing the rate of charge retroactively, thus assuming that the application of the income under this new facility should be considered separately. Under the circumstances, we find the Managing Director's proposal to use the income from the SRF for FY 1998 to finance current and prospective costs of administering the ESAF Trust operations appealing, given the obstacles being faced in raising the needed financing for the ESAF-HIPC Trust. While we remain open to considering the use of the income from the SRF to increase the precautionary balances if it becomes necessary, at the time of our April 1998 meeting, we are of the opinion that if that becomes the case, then it would be justifiable to transfer this income to a new SCA-3, with the funds returnable to contributors on its dissolution.

Mr. Fernandez made the following statement:

In occasion of our last meeting on the SRF, this chair agreed with the staff that, in view of an increased exposure of the Fund, it was desirable to strengthen its prudential stance and, that, in this context, the highest priority was the addition of the extra-revenue generated by the SRF to precautionary balances. We continue to support these views.

First, as regards the use of the **non-SRF income**, we can support the Managing Director's proposal to reduce the rate of charge for the FY 1998, but I can understand the point made by the four Directors sitting on my right.

Second, the Managing Director suggested several options for the use of the extra-income of the SRF. Even though, we do not regard the transfer of the extra-income of the SRF to the ESAF trust as fully satisfactory, we are ready to support the Managing Director's proposal to cover the costs of administering the ESAF Trust out of the income deriving from operations under the SRF.

Finally, the increase of the Fund's precautionary balances in the future should preferably be achieved by adding to the Fund's general reserves, for reasons addressed by Mr. Donecker.

Mr. Taylor stated that the Fund appeared to be doing a great deal more business off the same capital base in much more uncertain circumstances. Therefore, there was no windfall for general or particular distribution at the current stage. Mr. Fernandez had expressed his position regarding the **non-SRF income**. That income could be divided reasonably, but if there were a consensus to do as the Managing Director proposed, he would not stand out from that. The remainder should be placed to the precautionary balances, and not distributed. A suspense account, as Mr. Sivaraman had proposed originally, if acceptable in both a legal and an accounting sense, should also not be taken off the table. However, it would be inopportune, at the current juncture, to consider reimbursing the GRA for the cost of operations of the ESAF-HIPC Trust.

Mr. Wijnholds made the following statement:

Let me start off by saying that I support the proposed reduction in the coefficient of the rate of charge to 107 percent.

On the issue of the SRF income, I am in favor of allocating the additional income to reserves. In and of itself, the SRF is a facility which carries more risk than other facilities. Money is disbursed in a crisis situation, heavily front-loaded and in the context of a program that had to be designed in a hurry. More in general, the drastic decline in the ratio of reserves to outstanding credit warrants a more rapid accumulation of reserves.

With regard to the vehicle for reserves, I would favor a vehicle which offers the best protection. This might be the general reserves, if it leaves our net income target unchanged. It might be a new Special Contingency Account, if combined with clear limits on what can be done with the money once the Account is dissolved. But given what was said on this matter this morning the SCA route seems problematic.

Finally, I would not for now favor the use of SRF income for ESAF-HIPCs. As I noted in our November discussion on financing ESAF-HIPCs, I would like to keep a clear distinction between the concessional ESAF and the monetary character of the GRA.

Mr. Barro Chambrier made the following statement:

This chair considers critical that the level of the Fund's precautionary balances be maintained to a comfortable level, given the exposure risk to the Fund's resources from the growing expansion of the geographical concentration of Fund credit.

On the **non-SRF income**. During our previous meeting on the Fund income position for FY 1998, this chair indicated its inclination to use part of income excess to reduce retroactively the rate of charge to at least 108 percent of the SDR rate for the first half of the financial year and also to reduce the coefficient for the period starting November 1, 1997. Today, I think we can reduce further the rate of charge without endangering the Fund's financial situation. Therefore, as the Fund's net income has been in excess of its target, I can support a reduction of the coefficient of the rate of charge, as suggested by Managing Director in decision 1.

On the use of income from the SRF. I share the Managing Director's view that the income under the SRF should not be taken into consideration for the purpose of retroactively reducing the rate of charge for FY 1998. As regards the proposed options for the use of the income generated by the SRF, in light of the facts identified in the staff report, I see merit regarding the options related to addition to precautionary balances and to the financing of ESAF-HIPC operations. Regarding the addition to precautionary balances, I can agree to review the issue at the end of the financial year. Therefore, I could find appropriate the transfer of income from SRF to the existing SCA-1.

As regards the financing of the ESAF-HIPC, in light of the continued difficulties facing this institution in raising bilateral contributions for ESAF-HIPC Trust and delays in gold sales, I can broadly endorse the Managing Director's proposal to use income from the SRF for FY 1998, so as to meet current and prospective costs incurred by the General resources Account of administering the ESAF Trust.

Mr. Han made the following statement:

First of all, I agree with the Managing Director's proposal for splitting the Fund's income into a regular one and the one from the SRF. I can go along with his suggestion that the coefficient of the rate of charge be reduced to 107 percent of the SDR rate for the entire 1998 financial year, taking into account the projected excess SDR 83 million of regular income over the net income target.

On the use of the income generated from the SRF, I think the most important use of such income should be an addition to the Fund's precautionary balances, in view of the Fund's increased exposure to risks. I look forward to the discussion on the adequacy of the precautionary balances in April. I support the establishment of the new SCA-3, where the accumulated money should be returned to contributors in proportion to their respective contributions to the SRF when repurchases under the facility have been completed.

I share some of Ms. Srejber's concerns on the use of the income from the SRF for financing ESAF-HIPC operations. It is also my view that more efforts could be made in obtaining bilateral contributions or an early gold sale to the ESAF-HIPC Trust Fund. Too heavy reliance on the Fund's income for the ESAF-HIPC operations could possibly further defer bilateral contributions.

Finally, in view of the large amount of money involved in recent transactions under the front-loaded Korean program, I suggest that some part of the income from the surcharge of the SRF be returned proportionally to contributors under the facility at an early date.

Mr. Joyosumarto made the following statement:

From the statement by the Managing Director, it is clear that the **non-SRF income** for FY 1998 is now likely to nearly double the initial staff estimates of April 1997. As such, we can support Managing Director's proposal to reduce the coefficient of the rate of charge to 107 percent for FY 1998, including retroactively for the first half of the year.

With regards to the income earned from the SRF, this chair's preliminary views are as follows:

First, the income from the facility can indeed be significant, but use of the facility is difficult to forecast. As such, the staff should continue to exclude SRF income in considering the rate of charge in order to avoid undue volatility in the coefficient of the rate of charge.

Second, purchases under the SRF would tend to be exceptionally large, increasing the Fund's exposure to risks. We would thus prefer that all income generated from use of the facility be channeled toward strengthening the Fund's precautionary balances. We are not yet decided as to how best this can be done and would prefer the staff to further clarify the options that are available and the impact they would have on future Fund income and rate of charge.

Third, we do not support the use of income from the SRF to finance the operations of ESAF-HIPC, as it would discourage further bilateral contributions to ESAF.

Mr. Rouai made the following statement:

On income from regular facilities, I support the staff's proposal to reduce the coefficient of the rate of charge to 107 percent for FY 1998, including for the first half of the FY 1998. I can even support a lower coefficient. In any event, I reiterate that any remaining excess income should be refunded at the end of the year.

On income from SRF, my position is similar to that of Mr. Vernikov. My preference is that the added resources generated by the surcharge should be deposited in a new Special Contingency Account. Since the reasoning behind the surcharge is to encourage countries to make early repurchases, these contributions should be refunded at the time of the repurchase when the covered risk ceases to exist. I cannot support any other use of income derived from the surcharge because the SRF and its income are of a temporary nature and should not be considered a permanent source of financing for the Fund. This is particularly true with regard to the use of the added income for the ESAF-HIPC financing. Such decision is not transparent and will certainly further discourage bilateral contributions and delay gold sale.

However, I recognize the added risks implied by the SRF and, therefore, I propose the following:

The SRF income from service charges and the application of the regular rate of charges (SDR 36 million and SDR 8 million, respectively, for FY 1998 as indicated in the Managing Director's statement) should go to consolidation of the General and Special Reserves to compensate for added risks.

The income from the surcharge (SDR 66 million for FY 1998) should be deposited in a new SCA to be refunded to contributors. If there is no support for a new SCA, I support use of the resources to alleviate burden sharing.

In this connection, could the staff confirm my reading of the decision on the SRF, namely that the applied rate of charge is the adjusted rate for burden sharing? If so, the contribution of SRF users to burden sharing will lead to a commensurate reduction in other members' contribution.

Mr. Yoshimura made the following statement:

As regards the **non-SRF income**, we should take into consideration the fact that the financial crisis in Asia and elsewhere is not over yet. The increased risk to the General Resources Account due to large-scale purchases remains. Against this background, while I can agree to the reduction of the coefficient of the rate of charge to 107 percent, it is not appropriate at this stage to take a decision about a reduction retroactive to the beginning of this year. For the sake of prudence, the reduction should be applied to the second half of the financial year, and the ratio of excess income should be kept until the end of the financial year, as proposed in the staff paper.

I have strong doubts about the appropriateness of using the income from the SRF to cover the administrative costs of the ESAF Trust. If the Fund decides to use creative accounting of this type, the Fund would be sending countries a very inconsistent message about fiscal transparency. Rather, income from the SRF should be used to add to the precautionary balances of the General Resources Account, given the additional risks to that Account stemming from purchases under the SRF.

Regarding the kind of accounting mechanism for administering those additional precautionary balances, we prefer a new SCA-3, as it is a natural way to reflect the Fund's cooperative character. If there is income from the SRF remaining, it should be used to lower the rate of charge, or reduce the cost of burden sharing for both creditors and debtors.

Mr. Kiekens made the following statement:

In discussing the Fund's income position for financial year 1998, I will distinguish between income derived from the Funds regular facilities and income derived from the Special Reserve Facility.

The income derived from regular Fund operations will considerably exceed the net income target for 1998. However, the Fund's increased income is generated by operations that increase the Fund's risk. I therefore propose that we consider, for the remaining months of FY 1998, increasing the income target above its present level of 5 percent, and at the end of FY 1998, putting the excess income into reserves or precautionary balances instead of using it to reduce the rate of charge retroactively. But since the discussion so far shows no sufficient majority for doing this, I have reluctantly to accept the Managing Director's proposal.

As to the income derived from the SRF, the guiding principle should be to reinforce the Fund's precautionary balances. I do not agree that the SRF surcharge should be reimbursed to the members who have benefited from the SRF. The net income generated by this new facility should be added to the Fund's general reserves.

For the time being, I hesitate, for the reasons mentioned by Mr. Wijnholds, to agree with the proposal to use part of the SRF income to meet current and future costs to the General Resources Account (GRA) of administering the ESAF Trust. This cost is estimated at about SDR 40 million a year. Before accepting such a proposal, I would like to see a legal opinion showing how general resources of the Fund can be used to finance expenses of the ESAF Trust. If this would be possible, I wonder whether it would also be possible to use Fund income to provide interest subsidies to the ESAF Trust.

At the outset of this meeting, the General Counsel explained to the Board that a special contingency account, at its dissolution, can only be reimbursed to the contributors to that account. I wonder whether it is not possible to determine more freely the beneficiaries of such an account. Adding the Fund's income to the General Reserves may ultimately result in a distribution of excess reserves to Fund members in proportion to their quotas. However, we know that the Fund's income is not generated on a quota related basis. I therefore wonder whether we cannot define, when setting up a special contingency account, a rule for distributing excess income, which is not related to quotas but to members' contributions to the Fund's income, but without making too close a link between paying the surcharge on the SRF, which covers the higher risk to the Fund of SRF operations, and the entitlement to an eventual distribution of excess reserves in a contingency account.

Mr. Kaufmann made the following statement:

As regards the higher than expected **non-SRF income**, we agree that part of this excess be used to reduce the rate of charge retroactively, as proposed by the Managing Director in his statement.

On the use of the SRF income, we think that the additional income created by the SRF should be used to increase the Fund's reserves. This is warranted in light of the large amounts made available under the SRF. Such a use of the additional income for increasing precautionary balances is compatible with the rationale for demanding a surcharge on SRF credits.

On the question of where to put the proceeds, at this stage we clearly favor the solution of directing them to the general reserves, and not to a new SCA-account.

Finally, we are opposed to using SRF income to pay the administrative costs of the ESAF. This amounts to a transfer of the Fund's own resources to the ESAF-HIPC Trust. More generally speaking, we should not treat the SRF income as manna from heaven for the Interim ESAF, the HIPC Initiative, or any future initiative. Instead, we should use these resources according to the rationale for levying a surcharge.

The Treasurer stated that the Managing Director's statement had not included the option of using SRF income for reducing burden sharing because the Managing Director had formed the impression, on the basis of informal contacts with Directors, that most would support either placement of that income to reserves, or for the purpose of offsetting the administrative costs of operating the ESAF-HIPC Trust. Furthermore, the burden-sharing arrangement that covered both creditors and debtors could be subsumed under the position of reserves because, as the burden-sharing arrangement financed the SCA-1, so any change in the burden-sharing arrangements could have an impact on SCA-1, as well as on the impact on income of deferred charges. For those reasons, emphasis had been placed on how much, if any, of the income should be placed to reserves, and in particular, whether the amount placed to reserves should be refundable, along the lines of a new SCA-3, or more permanent.

As indicated in the staff paper of December 1997, there were four options remaining to the Board for disposing of the income from the SRF, the Treasurer pointed out. A very large amount of income was projected to accrue from operations under the SRF. The issue was whether or not that income should be taken into account in determining any retroactive reduction in the rate of charge. With respect to Mr. Rouai's point, the reduction would apply to the regular rate of charge, not the SRF surcharge.

The General Resources Account would not be used to finance the ESAF, the Treasurer emphasized. The ESAF Trust paid to the General Resources Account, through the Special Disbursement Account, the costs incurred by the General Resources Account for administering the ESAF Trust. It was, therefore, a transfer from the ESAF to the General Resources Account. The Managing Director's proposal was based on the suggestion that the General Resources Account should bear the costs of administering the ESAF Trust, and that there would not be a transfer from the ESAF Trust to the General Resources Account.

The General Counsel, addressing the question as to the legal basis of special contingent accounts, stated that the existing special contingent accounts were not based on the creation of an artificial liability for the purposes of setting money aside and leaving its disposition undecided at the end of the year. The Executive Board had created a precise mechanism under which additional income stemming from a higher rate of charge, or a lower rate of remuneration, would be returned to the contributing members if a certain event materialized. More specifically, the debtors that had paid the full rate of charge would receive a partial refund of the rate of charge, and creditors that had received lower remuneration would receive the full amount of remuneration. The power that had been exercised by the Fund had not been for the purpose of making a kind of gratuitous payment. It stemmed from the Fund's power to reduce the rate of charge and to increase the rate of remuneration, at least within the parameters established by the Fund.

Mr. Newman observed that there did not appear to be sufficient majorities for any of the proposals. He wondered what the next step would be.

The General Counsel replied that, at the end of the financial year, there would first be an automatic, retroactive reduction of the rate of charge, based on the amount of **non-SRF income**. The question would remain as to the disposition of income from use of the SRF. That income could also be used to reduce the rate of charge, if there were a 70 percent majority in favor of that. With an 85 percent majority, the SDR 40 million due to the General Resources Account for the costs of administering the ESAF Trust could be abrogated, reducing net operational income from the SRF, as the Treasurer had explained, and an equivalent amount transferred from the ESAF Reserve Account to the ESAF/HIPC Trust, via the Special Disbursement Account. Placement of the remaining SRF income to the general or special reserve, or the distribution of that income to members on the basis of quotas, could be decided by a simple majority of the votes cast.

Mr. Newman commented that he was intrigued by the last option mentioned by the General Counsel, as his authorities would get about 20 percent of the net income in that case. Also, it had been his impression that a 70 percent majority of the voting power in the Board would be needed to declare a dividend.

The General Counsel explained that there was a difference between a distribution of net income at the end of the year and a distribution from the general reserve. Seventy percent of the voting power in the Board would be needed to take out and distribute to members, on the basis of quotas, amounts that the Board had already placed to the general reserve. A decision on the distribution of net income at the end of the year—before it had been placed to reserves—required a simple majority of the voting power in the Board.

The Treasurer added that if no decision at all were taken, then the first decision would stand—net nonSDF income would lead eventually to a reduction in the rate of charge, retroactively to May 1, 1997. The remaining amounts of SRF income could not stay in a suspense account over the financial year. A decision would have to be taken with regard to the disposition of the Fund's income before April 30, 1998.

Mr. Shaalan suggested, as a compromise, that a decision be taken to reduce retroactively the rate of charge on the basis of the **non-SRF income**, with the resources accruing in FY 1998 from the use of the SRF to be divided in some way between the precautionary balances and the ESAF-HIPC Trust.

The Acting Chairman recalled that some speakers were also proposing that nonSRF excess income accruing from the present time until the end of the financial year not be applied to any retroactive reduction in the rate of charge.

Mr. Shaalan, replying to a request for clarification from Mr. Newman, said that when he spoke of the SRF resources, he meant the income from the surcharge on SRF resources. He was open on the issue of the distribution of the SRF income. However, perhaps the Treasurer could provide the Board with an indication of what he believed to be the appropriate level of precautionary balances that would be needed as a result of the expansion of the Fund's operations.

The Treasurer replied that, as the Managing Director had indicated in his statement, that was something to which perhaps the Board might wish to return, on the basis of a more extensive staff paper, after the spring Interim Committee meeting. At the present stage, it was difficult to indicate a particular number. In any case, that had always depended on the judgment of the Board made on the basis of circumstances at the time of the judgment.

Mr. Giustiniani observed that there did not appear to be a sufficient majority to enable the distribution of part of the income from the SRF to the ESAF-HIPC Initiative. He wondered how Mr. Shaalan's compromise proposal fitted into that.

Mr. Shaalan explained that the Managing Director's original proposal had been to transfer for purposes of the ESAF-HIPC Trust Fund the full amount of income arising from the SRF surcharge, namely, SDR 110 million. His own proposal was for a different distribution, with part of the money going to the reserve account to cover the increased costs, and part of it going to the ESAF-HIPC Trust.

Mr. Yoshimura commented that many Directors had emphasized the importance of increasing precautionary balances because of the new SRF lending. The Board needed to know how much of an increase was necessary. Perhaps the Board should return to the matter in April because, as the Treasurer had said, it was hard to put a precise number at present on what the increase in the precautionary balances should be. It would appear that no further progress would be made at the current juncture.

Mr. Wijnholds commented that it might be wise to return to the issues at a later time. The Board should not be rushed into something that it did not fully understand.

The Acting Chairman observed that Fund income was derived from both its regular facilities and the SRF. While the totality of the income needed to be considered in discussing how to dispose of the net income, the difference between SRF and **non-SRF income** also needed to be recognized. Views were divided on the question of how to dispose of the SRF income. It appeared that a consensus would not be reached on that day.

Mr. Shields commented that although there was support for the net income target for the current financial year and the allocation of net income until the current date, there was no agreement as to what should be done about the net income that would accrue between the present day and the end of the financial year.

Mr. Newman stated that he believed that it would be a mistake to take the decisions piecemeal. Either the decisions relating to all aspects of the income target and the disposition of the net income should be taken together, or none of them should be taken. He would not want to take them up in separate parts. Therefore, he could not support one decision without a decision being taken on the other aspects as well.

Messrs. Donecker, Giustiniani, and Shields said that they supported Mr. Newman.

Ms. Srejber stated that she also supported Mr. Newman. Also, she wished to stress that she would be open to reconsidering the income target for the current financial year, and the related Board decision.

The Treasurer commented that the decision as to the disposition of the net income from the present day until the end of the financial year was also in the hands of the Board.

The Secretary stated that a decision on the disposition of the net income from the present day until the end of the financial year would reopen the decision taken in April 1997, for which, as the General Counsel had pointed out, a 70 percent majority of the voting power would be required. There was not such a level of support in the Board for that at present.

The Treasurer pointed out that, as a factual matter, if there were to be a decision in favor of changing prospectively the net income target, the amount of income accruing to the Fund through end-January 1998 would be sufficient to reduce the coefficient of the rate of charge to 107 percent of the SDR interest rate in any event.

The General Counsel said that, for any decision to be prospective, it would have to be taken at the current juncture. If the Board waited until the end of the financial year to take it, it would be a retroactive, not a prospective decision, and the Board would have the same problem that it had at present with respect to the disposition of the net income that had already accrued.

Mr. Donecker suggested that the Board return to the issue in a week's time.

The Acting Chairman observed that there was insufficient support for any of the proposed decisions.

The General Counsel, responding to a question from Mr. Newman, confirmed that the current decision on charges only applied to the current financial year, and that for the following year, the Board could set any net income target it wanted.

The Acting Chairman made the following concluding comments:

> This has been a very fruitful discussion on the issue, although there is no consensus on the proposals made by the Managing Director. We will need to come back to the entire issue again. In the meantime, the decision on the net income target and rate of charge that was taken on April 21, 1997, remains in effect.
>
> Regarding the disposition of the income from the Supplemental Reserve Facility, four options were first indicated. The Managing Director has concentrated on two of those four options; namely, precautionary balances and the ESAF-HIPC Trust. Again, we cannot take any decision on this matter today; it will also be discussed in due course.
>
> There was strong support for using the income from the Supplemental Reserve Facility for strengthening the Fund's precautionary balances. While views differed on the appropriate vehicle, I detected strong support for an addition to the Fund's general reserves. However, there was also support for establishing a new special contingent account—although some Directors explicitly objected to such a new account. Interest was also expressed in further exploring the idea of holding the amounts in suspense, recognizing that this could only be done until the end of the financial year, when the Fund's books need to be closed. Several Directors advised against a discussion of provisioning.
>
> We will also need to come back to the issue of using resources that would be refunded to the General Resources Account for financing administrative expenses of ESAF-HIPC activities. Views differed on this issue. While several Directors strongly supported such use, several other Directors either reserved their position until after a discussion had been held on the adequacy of precautionary balances, or raised concerns regarding the appropriateness of using these resources in light of the possible effect on bilateral contributions, or on debtors.
>
> On the basis of today's discussion, we will continue to deliberate further on these issues in various forums, including through informal contacts with Directors, and perhaps discussion in an informal session.

Mr. Newman commented that it was difficult to secure special majorities, and often, in the end, decisions were taken by default, which in his view was not optimal. He would hope that the Board would return to the issues fairly soon, and in any case before April 30, 1998. In that context, he hoped that his colleagues would take to heart Mr. Donecker's plea for flexibility and compromise. His chair could have gone along with using SDR 83 million to reduce the rate of charge, with a large portion of the SRF income going to finance the operations of the ESAF-HIPC Initiative. Directors might want to consider a compromise that split the income in three ways equally for the current financial year, and then decide later what to do with future income from the SRF and other income.

The Acting Chairman observed that to the extent income from the SRF surcharge were used to reduce the rate of charge, as Mr. Newman was suggesting, the remainder of the income could be used for some other purpose. He hoped that, after more groundwork had been done, the Board could return to the outstanding issues as soon as possible, perhaps before the end of the month.

Mr. Barro Chambrier said that he wondered whether Mr. Donecker would be ready to share the terms of the compromise proposed by Mr. Newman, especially regarding the possibility of financing some of the expenditures of the ESAF-HIPC from the income of the SRF.

Mr. Donecker replied that strengthening the cooperative nature of the Fund, especially with respect to financing issues, was paramount. The insistence on the part of the debtor countries with regard to the use of the net income of SDR 83 million accruing over the remainder of the financial year was not helpful in convincing his authorities that they should always support the Fund, while disregarding their own interests. Nevertheless, in a cooperative spirit, he was prepared to support applying SDR 40 million from the net income of the current financial year to offset the administrative costs to the GRA of carrying the operations of the ESAF-HIPC Trust.

Mr. Barro Chambrier commented that he interpreted in a positive way Mr. Donecker's remarks. He hoped that decisions would be taken before the end of the financial year.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/98/3 (1/9/98) and EBM/98/4 (1/12/98).

2. EXECUTIVE BOARD TRAVEL

Travel by an Assistant to Executive Director as set forth in EBAM/98/3 (1/7/98) is approved.

3. TRAVEL BY MANAGING DIRECTOR

Travel by the Managing Director, as set forth in EBAP/98/4 (1/9/98), is approved.

APPROVAL: May 28, 1999

REINHARD H. MUNZBERG
Secretary

Projected Net Income
(In millions of SDRs)

	April 1997	Midyear Projections	Updated Projections	Net Income Target	Excess Net
Income					
Regular Fund income:					
Service charges 1/	30	57	75		
Margin on use of Fund credit 2/	398	417	424		
Other 3/	-329	-322	-317		
Net income	99	152	182	99	83
	April 1997	Actual	Projected		
Supplemental Reserve Facility:					
Service charges	--	21	36		
Margin on use of Fund credit 2/	--	-- 4/	8		
Surcharge	--	3	66		
Income of SRF	--	24	110		

1/ Including fees on undrawn balances at expiration of Stand-By or Extended arrangements.
2/ Charges on use of Fund credit less cost of remuneration/use of the Fund's SDR holdings.
3/ Net administrative expenses (i.e., after reimbursements from the SDR Department and the SDA) less settlement of pre-burden-sharing charges.
4/ Less than SDR 0.5 million.