FOR AGENDA

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EBS/94/28

CONFIDENTIAL

February 18, 1994

To: Members of the Executive Board

From: The Secretary

Subject: The Cost of Financing the Fund and its Distribution - Review of Burden Sharing

The attached paper on the cost of financing the Fund and its distribution and related issues is tentatively scheduled for discussion on Wednesday, March 9, 1994. A summary and conclusions appear on pages 24-28.

Mr. David Williams (ext. 38305) or Mr. Keuppens (ext. 37813) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

Other Distribution:
Department Heads

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

The Cost of Financing the Fund and its Distribution - Review of Burden Sharing

Prepared by the Treasurer's Department

(In consultation with other departments)

Approved by David Williams

February 18, 1994

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I. Introduction

This paper discusses issues related to the costs incurred by the Fund in carrying out its tasks, the means by which these costs are presently financed, and also whether changes in the financing arrangements might be contemplated to bring about what a number of Directors have suggested would be a more "equitable" distribution of the financing of these costs. The paper is intended as a discussion paper. Various alternative approaches are offered for the consideration of the Executive Directors, but no recommendations are put forward by the staff. The paper does not deal with issues that would arise in connection with gold sales by the Fund. When considering the paper, Executive Directors may wish to indicate the areas where they believe further staff work should be undertaken. Many, but not all, of the alternative financing arrangements that are discussed would need an amendment of the Articles of Agreement if they were to be implemented. The alternative means of financing the costs of operating the Fund are not worked out in full detail, but they could be further developed in the light of the discussion by Executive Directors and the priorities they would set regarding these matters.

The paper is organized as follows: Section II discusses the main categories of the total cost incurred in operating the Fund, i.e., administrative expenses, operational expenses (mainly remuneration and interest on borrowing), and the accumulation of precautionary balances--the annual addition to reserves (i.e., the target amount of net income) and additions to Special Contingent Accounts No. 1 (SCA-1) and No. 2 (SCA-2), which were established in the light of the problem of overdue obligations to the Fund--and describes briefly the various means by which these costs are financed at present. Section III describes some alternative means of financing the Fund's costs which could be considered under the present Articles and also, if it were desired to change fundamentally the present distribution of financing the Fund's operating and administrative costs, through changes in the Articles of Agreement. Section IV summarizes the paper and its conclusions.

II. Costs Incurred in Operating the Fund

1. Administrative expenses

The Administrative and Capital Budgets govern the administrative expenses of the Fund. The Fund's administrative expenses are absorbed by the General Resources Account (GRA), after deduction of the reimbursements of the estimated cost of conducting the business of the SDR Department and of the cost of administering the SAF and ESAF, which are obtained through assessments levied on participants' net cumulative allocations of SDRs in the SDR Department and by a transfer of resources from the Special Disbursement Account, respectively. Table 1 summarizes the Fund's administrative and operational costs since FY 1980, and the various sources of income which financed these costs.

Table 1. The Fund's Expenses, Sources of Income, Rate of Charge and SDR Interest Rate
FY 1980 - 1994

(in million of SDRs and in percent)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994 *
Cost Elements and Net Income															
Administrative expenses	87.8	101.8	155.4	193.9	195.8	227.8	227.1	200.6	185.7	187.5	206.0	205.0	251.6	282.7	350.9
Remuneration expense	241.0	372.8	908.6	981.1	1,286.3	1,721.2	1,452.1	1,110.0	994.8	1,130.0	1,383.3	1,314.1	1,152.8	1,116.8	1,014.8
Interest on borrowing	284.0	329.5	634.9	807.4	1,239.8	1,566.5	1,275.8	927.2	774.6	515.0	345.0	317.9	286.6	222.1	148 0
Charges deferred, net of settlements	--	--	--	--	--	56.4	64.3	167.9	170.5	250.8	244.4	114.5	100.3	(98.3)	33.9
Allocation to SCAs	--	--	--	--	--	--	--	26.5	60.4	62.9	65.0	212.1	229.7	255.3	260.5
Net income (deficit)	3.1	80.1	92.0	65.4	73.0	(29.8)	78.1	86.0	49.1	54.2	85.5	69.9	89.9	70.6	63.1
	615.9	884 2	1,790.9	2,047.8	2,794.9	3,542.1	3,097.4	2,518.2	2,235.1	2,200.4	2,329.2	2,233.5	2,110.9	1,849.2	1,871.2
Sources of Revenue															
Periodic charges	519.4	592.7	1,092.1	1,545.4	2,363.8	3,025.6	2,801.6	2,154.6	1,915.7	1,786.2	1,878.1	1,739.1	1,708.0	1,392.0	1,198.7
Burden sharing adjustments, net of refunds															
Charges	--	--	--	--	--	--	--	90.1	99.7	141.6	127.1	114.6	127.8	52.8	130.1
Remuneration	--	--	--	--	--	--	--	89.9	99.6	141.4	127.1	173.6	168.6	103.5	176.8
Special charges	--	--	--	--	--	--	2.3	12.1	20.1	42.5	64.3	85.5	19.0	25.0	5.5
Interest on SDR holdings	81.8	265.8	657.2	444.3	371.6	478.3	263.2	143.9	66.0	61.3	88.2	70.9	56.9	217.4	298.5
Service charges/other income	13.0	23.8	39.5	55.6	56.5	34.6	26.6	17.9	23.4	12.6	27.0	34.2	11.2	39.1	37.7
Reimbursements for administering:															
Trust Fund	0.7	0.3	--	--	--	--	--	--	--	--	--	--	--	--	--
SDR Department	1.0	1.6	2.1	2.5	3.0	3.6	3.7	4.1	3.7	3.7	4.3	3.7	4.1	2.9	3.2
SAF/ESAF	--	--	--	--	--	--	--	5.6	6.9	11.1	13.1	11.9	15.3	16.5	20.7
	615.9	884.2	1,790.9	2,047 8	2,794.9	3,542.1	3,097.4	2,518.2	2,235.1	2,200.4	2,329.2	2,233.5	2,110.9	1,849.2	1,871.2
Rate of charge (ordinary resources)															
Basic	5 25	5.30	6.25	6.60	6.60	7.00	7.00	5.89	5.37	6.43	8.34	7.65	6.88	5.60	4.73
Adjusted for burden sharing	5.25	5.30	6.25	6.60	6.60	7.00	7.00	6.38	6.00	7.38	9.34	8.92	8.02	6.55	5.42
SDR interest rate	7.87	9.45	13.03	10.09	8.69	8.77	7.40	6.01	5.74	7.05	8.66	8.79	7.12	5.72	4.27

* Projected.

The total administrative cost of running the Fund is estimated to amount to approximately US$477 million (SDR 351 million) in FY 1994, of which approximately US$443 million (SDR 327 million) will be incurred by the GRA. This represents about 23 percent of total (operational plus administrative) expenses incurred in running the Fund in FY 1994. The bulk of administrative disbursements are made in U.S. dollars (and to a certain extent in other currencies, in particular French francs) and are financed from the Fund's currency holdings. Administrative disbursements increase the Fund's remunerated positions, but these costs are recovered through the Fund's income (mainly charges).

Disbursements under the Capital Budget are, for the most part, capitalized and charged against income (depreciated) over the estimated useful life of the asset. The direct cost of capital expenditures each year is the annual depreciation charged to income; in addition, there is a (small) cost of financing these capital disbursements (i.e., the additional remuneration incurred as a result of the disbursement of currencies, pending full financial recovery of the asset that is being depreciated over time).

2. Operational expenses

The Fund pays remuneration to a member on the amount by which the Fund's holdings of a member's currency are below its norm for remuneration (after deducting holdings of currency that have been excluded for purposes of defining the reserve tranche), i.e., remuneration is paid on a member's net creditor position in the Fund. The remuneration norm and its relative significance in the financing of the Fund are discussed below (pp. 9-10).

A creditor position in the Fund is achieved or enlarged if a member's currency is used in the Fund's operations and transactions (or when administrative payments are made in that currency). The Fund pays remuneration on these positions at the SDR interest rate, 1/ which in turn is determined by the combined three-month (mainly treasury bill) market interest rates for the currencies in the SDR valuation basket. 2/ This link makes the rate of remuneration directly dependent on the level of short-term market rates in the five leading money markets in the world. The SDR interest rate is calculated on a weekly basis. The Fund's remuneration expense (and the amounts retained under the burden sharing arrangements) is shown since FY 1980 in Table 1; for FY 1994, total remuneration expense amounted to SDR 1.01 billion.

In the past, the Fund has also supplemented its resources by direct borrowing from its members so as to finance special facilities such as the Oil Facilities, the Supplementary Financing Facility, and the Policy on Enlarged Access. The Fund is in the process of repaying borrowed resources,

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1/ The rate of remuneration at present is further adjusted under burden sharing, as discussed below.

2/ The French franc, the deutsche mark, the Japanese yen, the pound sterling, and the U.S. dollar.

and currently outstanding borrowing (about SDR 3.1 billion) reflects borrowing under the Policy on Enlarged Access. (The Fund also has available the credit lines under the General Arrangements to Borrow, but these credit lines have not been called upon.) The cost of borrowed resources under the enlarged access policy is linked to the six-month SDR interest rate and is thereby also related to both the level of and changes in short-term market interest rates. Since May 1, 1993 the cost of borrowing has been aggregated with other operational costs in the Fund and is one of the factors included in the determination of the rate of charge necessary to achieve the Fund's income target. 1/

In sum, total remunerated Fund positions (SDR 23.3 billion), outstanding borrowing (SDR 3.1 billion), and available interest-free resources (SDR 5.4 billion) represent the counterpart to the outstanding use of Fund credit (SDR 24.8 billion) and the holdings of SDRs in the GRA (SDR 7.0 billion). Put another way, total interest-earning balances (use of Fund credit and SDR holdings) amount to SDR 31.8 billion and exceed the Fund's interest-costing balances (remunerated positions and outstanding borrowing) of SDR 26.4 billion by SDR 5.4 billion, which represents the Fund's available interest-free resources (discussed further below).

3. The Fund's reserves - net income target

The Fund annually determines a target amount of net income which reflects the desired addition to its General or Special Reserves. The net income target was first established in FY 1982, and the target amount of income was set at the equivalent of 3 percent of the Fund's reserves at the beginning of the financial year. As part of the Fund's response to the growing problem of arrears, the Fund raised the net income target from 3 percent to 5 percent of reserves in FY 1986. This net income target is additional to the Fund's operational expenses and is financed out of its operational income (charges). The Fund sets a rate of charge on the use of its resources which is expected to cover both operational and administrative expenditures as well as the agreed target amount of net income. Since FY 1990, the rate of charge has been set at the beginning of the Fund's financial year as a proportion of the SDR interest rate so that variable costs that are linked to the SDR interest rate (outstanding borrowing and remunerated reserve tranche positions) are covered by income from charges and from the Fund's SDR holdings which also vary directly with the level of the SDR interest rate. Nevertheless, because of changes in the total outstanding use of the Fund's resources--i.e., balances subject to charges--which cannot be estimated precisely, and also changes in the Fund's

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1/ Prior to May 1, 1993, the cost of borrowing was kept separate and entered in the equation to determine a rate of charge on the use of the Fund's borrowed resources. Since May 1, 1993, all outstanding Fund credit is subject to the same rate of charge, including the burden sharing adjustments, and the distinction between the cost of borrowed resources and the cost of the Fund's own resources has been dropped.

administrative expenditures when expressed in SDRs, it is often difficult to achieve the precise target amount of net income for a given year.

The Fund's net income target is set as a percentage of the Fund's reserves (General and Special) at the beginning of the financial year, at the present time 5 percent, which is equal to SDR 81 million for FY 1994. The target amount of net income adds approximately 5.4 percent to the Fund's operational and administrative expenditures that need to be covered by operational revenue, and presently represents 32 basis points of the rate of charge.

4. Temporary costs related to the Fund's arrears

The first decision on burden sharing was adopted in the spring of 1986 in order to share more equally among member countries the costs to the Fund of overdue financial obligations. Prior to the adoption of the decision on burden sharing, the costs of overdue obligations (i.e., the loss of income from the nonpayment, or deferral, of charges) were paid through increased charges on the use of the Fund's resources as was the Fund's net income target when it was raised from 3 percent to 5 percent of reserves. Burden sharing was introduced to alleviate the burden on debtors in respect of the cost of deferred charges by distributing that cost equally among debtors and creditors through adjustments to the rate of charge and the rate of remuneration. At the same time, the target for net income was increased from 5 percent to 7.5 percent, and this increase was also shared equally between debtors and creditors. After one year of burden sharing, the increase in the net income target to 7.5 percent, which had generated what had been called "supplemental income" in FY 1987, was replaced by the Special Contingent Account which was also to accumulate an amount equivalent to 5 percent of the Fund's reserves, to be financed equally through adjustments to the rate of charge and the rate of remuneration. These arrangements have continued in effect, except for the addition of extended burden sharing in 1990 as part of the strengthened cooperative strategy on arrears which led to the establishment of the SCA-2 (see below).

Under the decisions on Burden Sharing, adjustments are made to the rate of charge and to the rate of remuneration to finance (i) deferred charges due from members in protracted arrears, i.e., arrears that have been outstanding for six months or more; (ii) additions to the SCA-1; and (iii) additions to the SCA-2. When charges deferred since the adoption of the burden sharing adjustments are settled, the proceeds are used to make refunds to those members which paid higher charges or received lower remuneration when the charges were deferred. Similarly, when all overdue obligations have been settled--or earlier if the Executive Board so decides--the precautionary balances collected in the Special Contingent Accounts will be paid to the members who originally contributed them. The different components of burden sharing are briefly discussed in the following paragraphs. The amount of precautionary balances accumulated in the current financial year--i.e., additions to the Fund's reserves and to SCA-1 and SCA-2--will total approximately SDR 350 million, and SDR 95 million for deferred charges (net of refunds).

a. Deferred charges and SCA-1

In order to offset the shortfall of income resulting from the nonpayment of charges due from members in protracted arrears, and to limit the increase in the rate of charge needed to compensate for this shortfall, the Executive Board agreed that adjustments would be made to the rate of charge and the rate of remuneration which would each generate one half of the unpaid charges in each quarter. As noted above, when deferred charges are settled an equivalent amount is distributed to members that had paid higher charges or received reduced remuneration when the charges were deferred. Since burden sharing began, creditors and debtors have paid SDR 1,369 million to cover the cost of deferred charges, and SDR 602 million has been refunded following the settlement of deferred charges.

As regards overdue repurchases, the Executive Board agreed that precautionary balances would be built up in the SCA-1, which also would be financed from adjustments to the rate of charge and the rate of remuneration, in equal proportions, except that adjustments to the rate of remuneration to meet deferred income and the allocation to SCA-1 may not reduce that rate to less than 85 percent of the SDR interest rate. Annual additions to the SCA-1 have been equal to the target amount of net income (SDR 81 million or 5 percent of reserves in FY 1994); as mentioned, they are to be refunded when no longer needed. Total balances in the SCA-1 now amount to SDR 477 million.

b. SCA-2

Further adjustments to the rate of charge and the rate of remuneration have been made since July 1990 in order to accumulate, over a period of approximately five years, an amount of SDR 1 billion which is to be placed to SCA-2. Balances in the SCA-2 are intended to protect the Fund against the financial risks that arise in connection with the encashment of such rights and also to provide additional resources to the GRA to finance the encashment of rights following the successful completion of a rights accumulation program under the Strengthened Cooperative Strategy. The rate of charge presently is adjusted by 26 basis points to this end, and the rate of remuneration is adjusted so as to generate three times the proceeds from the adjustment of the rate of charge, subject to the limit to the rate of remuneration of 80 percent of the SDR interest rate prescribed by Article V, Section 9. To date, the amount accumulated in the SCA-2 is SDR 568 million of which the debtors have contributed SDR 196 million through an adjustment of the rate of charge and SDR 372 million has been contributed through a reduction in the rate of remuneration. The contribution to the SCA-2 through the adjustment of the rate of remuneration has been limited because the rate of remuneration has been reduced to the floor of 80 percent of the SDR interest rate, with the consequence that the creditors' contributions fall short of their intended contributions by SDR 214 million. The issue of the relative contributions made to the SCA-2, the level of balances to be accumulated in that account and the possibility of changing the amount of contributions financed through the rate of charge will be discussed in a

staff paper to be issued shortly for the consideration of the Executive Board.

5. Financing the Fund's expenditures

Under present arrangements, the Fund can finance its administrative and operational costs (including overdue obligations) in only three ways: (i) by levying charges on the use of its resources; (ii) by reducing the rate of remuneration, subject to it not falling below 80 percent of the SDR interest rate; and (iii) by imposing fees and assessments for services rendered - for example, from reimbursement of the cost of operating the SDR Department, from the Special Disbursement Account for the cost of administering the SAF and ESAF, and for the cost of providing financial services such as administered accounts or charging for the provision of technical assistance to members. As described below, the Fund has called on all three sources of income, though only to a limited extent under (iii). It should, however, be noted that there is no authorization in the Articles that would permit the Fund to impose levies on its member countries, say, in proportion of quotas, to finance either the total of or any class of expenditures that it incurs in the exercise of its assigned tasks. In addition, and as discussed in the following subsection, the Fund has available a relatively large mass of interest-free resources which importantly affects the level and distribution of costs in the Fund and their financing.

a. Interest-free resources

The Fund's interest-free resources have the overall effect of lowering the Fund's cost structure--both its administrative and operational expenses--to a substantial extent. The interest-free resources also affect the distribution of the financing of these costs, in particular the role of the nonremunerated reserve tranches. The Fund's interest-free resources represent mainly nonremunerated creditor positions, the Fund's reserves, including past sales of gold, and other precautionary balances. Interest-free resources reduce the overall cost structure of the Fund because they reduce remunerated positions and thereby help finance balances subject to charges at a lower rate of charge than would otherwise be the case. The amount of the Fund's interest-free resources varies over time, mainly reflecting changes in the Fund's precautionary balances and purchases in the nonremunerated reserve tranches. As shown in Table 2, net available interest-free resources at present amount to about SDR 5,420 million; in their absence, and other things being equal, the Fund would incur additional costs of about SDR 215 million at the present SDR interest rate of 3.99 percent, which is the equivalent of approximately 80 basis points on the rate of charge. The higher the SDR interest rate, the greater the impact of the interest-free resources on the Fund's cost structure.

The existence of the interest-free resources is of general benefit to the Fund, and it is not in practice possible to attribute the benefit of these resources to specific categories of the Fund's expenditure. Given the nature of the Fund's interest-free resources, it cannot be claimed, for example, that the administrative budget is financed from either debtor or

Table 2. The Fund's Interest-Free Resources
FY 1960 -1994

(in millions of SDRs and in percent)

	April 30,							Oct. 31,
	1960	1965	1970	1975	1980	1985	1990	1993
1. Subscription payments in excess of members' norm for remuneration 1/	3,268	3,810	5,176	7,290	7,312	7,380	7,453	8,115
2. Precautionary balances:								
a. Gold investment profits	22	148	366	424	424	424	424	424
b. Net income	40	142	351	284	339	620	973	1,304
c. Special Contingent Accounts	--	--	--	--	--	--	215	1,045
3. Excess of sundry liabilities over sundry assets 2/	(7)	(18)	(22)	43	183	--	(76)	(114)
4. Subtotal	3,323	4,082	5,871	8,041	8,258	8,424	8,989	10,774
5. Use of interest-free resources:								
Gold holdings	2,495	2,217	2,763	5,370	3,636	3,620	3,620	3,625
Use of nonremunerated reserve tranche	--	--	1,882	2,163	2,327	1,302	1,643	1,728
6. Available interest-free resources	828	1,865	1,226	508	2,295	3,502	3,726	5,421
7. Available interest-free resources (6) as a percentage of quota	5.80	11.66	5.74	1.74	5.88	3.92	4.13	3.74

1/ The Fund has paid remuneration on members' creditor positions since July 28, 1969. For FY 1960 and FY 1965, the amount represents quota minus holdings of a member's currency that are below quota.
2/ This mainly represents the amount by which the net receipt of assets on the Fund's income and expense transactions has exceeded net income on an accrual basis.

creditor members. In practice, the interest-free resources permit the Fund to earn a lower amount of income than is needed to meet both administrative and operational expenses than otherwise would be the case, and the rate of charge on the use of its resources is consequentially lower than would otherwise be the case. It is, however, to be noted that--other things being equal--any increment in administrative or operational expenses leads to a higher rate of charge or a lower net income for the Fund at any given level of interest-free resources under the present system of financing the Fund.

b. Nonremunerated reserve tranche positions

An important part of the Fund's interest-free resources is represented by members' nonremunerated reserve tranche positions (see Table 2), and it is sometimes noted that these positions are a source of financing normally provided by the creditor members. 1/ The nonremunerated position of a member represents that part of the Fund's holdings of a member's currency that the Fund can use in support of other members' adjustment policies without having to pay remuneration. The nonremunerated position reflects essentially the (reserve asset) subscription payments before the Second Amendment of the Articles that had to be paid in gold. The absolute size of the nonremunerated reserve tranche for each member that joined the Fund before April 1, 1978 is the size of its gold tranche at that date, which until the Second Amendment had not been remunerated. Expressed in terms of quota, the norm has increased in proportion to each increase in a member's quota. The norm for remuneration is calculated for each member as the sum of 75 percent of quota at the date of the Second Amendment (April 1978) and the increases in quota consented to and paid after that date. For members that joined the Fund after April 1, 1978, the nonremunerated reserve tranche is determined as the weighted average of the nonremunerated reserve tranches of all members expressed as a percentage of total quotas (and in terms of present quotas amounts to approximately 5.6 percent for these members). 2/

The remuneration norm differs from member to member, and the nonremunerated position, measured by the norm, is a different proportion of quota for each member; at present, the norm ranges from 89.9 percent (the United Kingdom) to 99.9 percent (Saudi Arabia). A number of Directors have taken the position that the "creditor" countries contribute substantial amounts to the financing of the Fund through its sale of currencies in the nonremunerated reserve tranches. They have also noted that these contributions should be taken into account as part of the regular financing of the Fund, for example, through the Fund's operational budget, in particular in

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1/ As a consequence of the Fund's general policy to exclude the holdings of its currency acquired as a result of purchases under the Fund's various facilities from a member's reserve tranche, a member could simultaneously be in the position of having outstanding a nonremunerated (and remunerated) reserve tranche and also balances subject to the rate of charge.

2/ For the member-by-member distribution of remuneration norms, see *'Norm' for Remuneration*, EBD/93/84 (5/7/93).

determining the allocation of currencies under the operational budget. 1/ However, the staff has explained that differences in members' norms were intended to result from Article V, Section 9, and that the allocation of currencies under the operational budget cannot be used to redistribute or harmonize nonremunerated reserve tranche positions to modify the effect of Article V, Section 9.

c. Sources of revenue for the Fund

Apart from the interest-free resources that are available to it, of which the nonremunerated reserve tranche positions of members represent the largest part, the Fund relies on the proceeds from the rate of charge levied on the use of its resources as its primary source of operational income (Table 1). The Fund's income from charges amounted to SDR 1,392 million in FY 1993, representing approximately 75 percent of all revenues accruing to the Fund. The Fund's income from its holdings of SDRs has, as its counterpart, higher remuneration expenses, and there is no net financial advantage to the Fund of holding SDRs over remunerated creditor positions. Proceeds from the reimbursements of the costs of running the SDR Department and transfers from the Special Disbursement Account for the cost of conducting operations relating to the SAF and ESAF are relatively small. 2/ The Fund has not levied charges for providing financial services through the administered accounts and charges for only a small part of the technical assistance it provides, though the Fund receives contributions from members to finance some technical assistance programs, in particular, those relating to the Japan Technical Assistance Account and the UNDP.

Second, the Fund also receives revenues from transaction fees levied on purchases, as well as from (refundable) stand-by and EFF commitment charges when arrangements are canceled or expire without being fully drawn. The relative importance of income from transaction fees depends directly on the volume of purchases; the lower the use of the Fund's resources, the smaller is the Fund's net income from this source--this normally needs to be compensated by a higher rate of charge on outstanding Fund credit (and vice versa). The settlement of charges deferred before May 1986 (i.e., before the adoption of burden sharing) and of overdue special charges (which are

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1/ This suggestion was analyzed in *Review of Guidelines for the Allocation of Currencies Under the Operational Budget*, EBS/91/218 (12/23/91), pp. 13-15.

2/ The assessment in the SDR Department that is levied to reimburse the General Department for the expenses of conducting the business of the SDR Department is estimated on the basis of time spent on SDR Department business by the Executive Board, the management, and the staff. The direct costs, such as telecommunication and EDP costs, are added to salaries and benefits. A third element, general overhead costs, is computed on the basis of the ratio of SDR Department-related costs (salaries, benefits, travel) to the Fund-wide costs for these items. The reimbursement for costs incurred in administering the SAF and ESAF are estimated using the procedures for estimating the costs of conducting the business of the SDR Department.

not burden shared) also results in unanticipated income for the Fund. As noted above, approximately SDR 82 million of deferred charges remain to be settled outside the burden sharing arrangements, and approximately SDR 178 million of special charges continue to be overdue.

Third, the Fund receives income from its holdings of SDRs and the lower the SDR interest rate the lower the Fund's income and vice versa. The Fund's holdings of SDRs are at present relatively large, and the income from these holdings is of the order of SDR 300 million, or the equivalent of 117 basis points on the rate of charge. As stated above, the revenue derived from these holdings is offset by higher remuneration expense.

d. Investment of the Fund's assets

It may also be noted that the Fund has no investment income to help finance its expenses, though, as a result of the Second Amendment, the Fund has the power to invest its currency holdings up to the equivalent of its General and Special Reserves (SDR 1.6 billion at present) to generate investment income. (The profits from a sale of gold by the Fund could also be invested in the Investment Account up to the equivalent of its General and Special Reserves.) In other words, and provided the Fund's liquidity position were sufficiently strong, the Fund could use its currency holdings to invest in income-generating assets rather than use these assets in its lending activities. However, it should be noted that an investment of the equivalent of the Fund's reserves would lower the currency holdings in the GRA and increase the Fund's remuneration expense - by approximately SDR 65 million at the current rate of remuneration. 1/ The rate of return on the Fund's investments of its currency holdings would, therefore, need to exceed the rate of remuneration. Furthermore, as the maintenance of value provisions do not apply in the Investment Account, the investment of the Fund's currency holdings would need to be placed in SDR-denominated assets, which, after deducting transactions costs and taking into account the need to maintain a relatively high degree of liquidity for the investments, would not normally yield a return much, if anything, in excess of the rate of remuneration. On balance then, on grounds of safeguarding the Fund's liquidity position, the need to avoid exchange risk and the need to cover the cost of remuneration, an investment of part of the Fund's currency holdings has not in the past seemed an attractive option or means to enhance the Fund's earnings. As a consequence, the Fund has not activated the Investment Account.

1/ If the Fund decided to sell gold and invest the profits in the Investment Account, the Fund would not only receive income from the investments but it would reduce its remuneration expense accordingly by the capital value of the gold that was sold.

6. Overall incidence of the Fund's operating cost

The incidence of the costs incurred in operating the Fund reflects, on the one hand, the fundamental financial structure of the Fund, which is based on resources derived mainly from the subscriptions of member countries that are made available to other members and, on the other hand, by historical factors which affect the composition of the Fund's assets, in particular payments that were made in the past in gold and are now paid mainly in SDRs. In addition, the structure of Fund financing reflects the specific constraints imposed by the present Articles which circumscribe the means available to it to meet its administrative and operational expenditures, including the costs arising from overdue obligations.

The financial operations of the Fund--the "lending" of its resources to member countries in support of adjustment programs--are based on the concept of an exchange of assets--the sale of currency or SDRs for a member's currency. The Fund is authorized to levy charges on the use of its resources; at the same time it is obligated, since the First Amendment of the Articles, to pay remuneration on the currencies it makes available to member countries (apart from the nonremunerated positions noted above). The financing extended by the Fund to its members thus normally of itself creates both income-earning assets (balances subject to charges) and cost-producing liabilities (balances earning remuneration). 1/ In short, the Fund's operational expense is effectively financed through the rate of charge levied on the use of the Fund's resources. However, for various reasons--for example, the cost of administrative expenses and the Fund's interest-free resources--the operational expenses of the Fund are not automatically self-financed by the Fund's operational income, i.e., the rate of charge is not normally the same as the rate of remuneration and the SDR interest rate.

Under the present system of setting the rate of charge, and (burden sharing adjustments apart) given that the rate of remuneration is equal to the SDR interest rate, the differential between the rate of charge and SDR interest rate essentially reflects (i) the availability to the Fund of

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1/ Within this basic framework, the use of Fund resources is normally met by the sale to one member of the currencies of (an)other member(s) or by a sale of SDRs. The use of SDRs held in the GRA to meet a purchase does not essentially differ from the use of the Fund's holdings of currencies: the loss of income on the Fund's SDR holdings replaces an increase in the Fund's remuneration expense. From a financial point of view, the Fund therefore is indifferent between a sale of currencies and a sale of SDRs because--apart from the (rare) sale of a nonremunerated currency--the rate of remuneration (the Fund's cost) is equal to the rate of interest on the SDR (reflecting the Fund's foregone income). There are, however, differences for member countries: the sale of currencies has an impact on (relative) remunerated positions which in turn affect the incidence of contributions under burden sharing, while a sale of SDRs leaves (relative) remunerated positions unchanged.

cost-free balances and (ii) the need to cover the Fund's administrative expenditures and the additions to precautionary balances. Issues have arisen as regards the size of this differential (see below) and whether the differential should in fact include the Fund's administrative costs, especially as they are financed from the use of the Fund's currency holdings and thus have the same effect as a sale of currency by the Fund (without, however, creating income-earning balances).

There is also no doubt that the burden sharing arrangements--though they are intended to be temporary--have fundamentally altered the distribution of the financing of the Fund's expenses by reducing the rate of remuneration. Prior to the onset of overdue obligations, and the subsequent burden sharing arrangements, the Fund was financed by levying charges on the use of its resources and through its interest-free resources. Table 3 attempts to assess the relative contributions of the debtor members--i.e., those paying charges on the use of the Fund's resources and burden sharing--and of the creditor members, i.e., by attributing the nonremunerated reserve tranche positions to creditor countries plus their share in the burden sharing arrangements. This attribution excludes the financing of the Fund's operational costs which, as noted above, are financed entirely through charges levied on the use of the Fund's resources. As can be seen from this table, the relative contributions of the two groups of members in financing the administrative expenses of the Fund and the Fund's precautionary balances are now approximately equal.

7. Criticisms of the present financing arrangements

Many Directors have aimed a number of criticisms at the Fund's present financing arrangements. Three such criticisms have been made on a number of occasions:

First, some Directors have objected to the present financing arrangements because the bulk of the costs incurred by the Fund are financed on the basis of members' operations with the Fund, i.e., through charges on the use of resources and, under burden sharing, also from a reduction in the rate of remuneration. The smaller are these operations and transactions, the greater is the burden on those members using the Fund's resources and on those providing resources to the Fund through the operational budget. This system also leaves out of the financing arrangements those members which have no outstanding use of the Fund's resources nor participate in financing the Fund through the operational budget, even though they continue to share fully in the benefits of Fund membership. 1/ Furthermore, some Directors have noted that under the present arrangements, those members with relatively large outstanding nonremunerated reserve tranches which are included

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1/ This group of members have an essentially neutral position in the GRA, i.e., the Fund's holdings of their currency amount to 100 percent of their quotas. The number of members in this position over the past year amounts to 18, and their quotas aggregate to SDR 3,887 million, or 2.7 percent of the total.

Table 3. Costs of Financing the Fund's Administrative Expenses and Precautionary Balances and Relative Burden on Members
FY 1980-1993

(in millions of SDRs and percent)

	Items in excess of operational expenses to be financed						Debtors' share			Creditors' share			Relative contribution (in percent)	
FY	Administrative expenses	Net income	Deferred charges	SCA-1	SCA-2	Total	Charges in excess of net operational expenses 1/	Burden-sharing contributions	Total	Imputed costs - NRT 2/	Burden-sharing contributions	Total	Debtors	Creditors
1982	153.3	92.1	--	--	--	245.4	245.4	--	245.4	641.4	--	641.4	27.7	72.3
1983	191.4	65.4	--	--	--	256.8	256.8	--	256.8	497.0	--	497.0	34.1	65.9
1984	192.8	73.0	--	--	--	265.8	265.8	--	265.8	436.4	--	436.4	37.9	62.1
1985	224.2	(29.8)	--	--	--	194.4	194.4	--	194.4	478.2	--	478.2	28.9	71.1
1986	223.4	78.1	--	--	--	301.5	301.5	--	301.5	411.9	--	411.9	42.3	57.7
1987	190.9	86.0	182.2	26.5	--	485.6	276.9	117.7	394.6	349.3	91.0	440.3	47.3	52.7
1988	175.1	49.1	153.7	60.4	--	438.3	224.2	107.1	331.3	340.0	107.0	446.9	42.6	57.4
1989	172.7	54.2	224.8	62.9	--	514.6	226.9	144.0	370.9	413.6	143.8	557.4	40.0	60.0
1990	188.6	85.5	235.3	65.0	--	574.4	274.1	150.2	424.3	502.0	150.1	652.1	39.4	60.6
1991	189.4	69.9	210.3	69.8	142.3	681.7	259.3	181.6	440.9	500.9	240.8	741.7	37.3	62.7
1992	232.2	89.9	190.0	73.4	156.3	741.8	322.1	189.3	511.4	398.0	230.4	628.4	44.9	55.1
1993	263.3	70.6	139.4	78.3	177.0	728.6	333.9	172.1	506.0	342.7	222.6	565.3	47.2	52.8

1/ Contribution by debtors in excess of the amount needed to cover operational expenses (mainly remuneration expense and the cost of borrowing net of reduction of the cost as a result of the interest-free resources). This is equivalent to the total of administrative expenses and net income.

2/ Cost of holding the nonremunerated reserve tranche is calculated at the average rate of remuneration in effect each year.

in the operational budget are in fact making relatively large contributions to the Fund's financing, and the size of their nonremunerated reserve tranches is not taken into account in allocating currencies under the operational budget. 1/ Finally, some Directors have argued that the allocation of currencies under the Fund's operational budget, which is based on the level of members' external reserves but also takes into account members' quotas, gives rise to difficulties in sharing the burden of financing the Fund's current operations and transactions among creditors because external reserves are no longer a reliable indicator of a member's external financial position and its ability to finance the Fund. These criticisms have led some Directors to the conclusion that a different basis for financing the Fund's operations and transactions should be considered, for example, on the basis of members' quotas in the Fund.

A second important criticism, which some Directors have aimed at the present financing arrangements, is that the rate of charge varies considerably and is a source of instability in the Fund's financial system. This variability is due to the close relationship between the rate of charge and the SDR interest rate, which results (i) in the rate of charge fluctuating around the SDR interest rate rather than bearing a relatively stable relationship to it and (ii) in a rate of charge which at times can be regarded as relatively high because of its link to short-term market rates. The rate of interest on the SDR is the pivotal rate around which the Fund's administrative and operational expenses fluctuate. However, the SDR interest rate is not itself a stable rate nor is its relationship with the rate of charge. The rate of charge bears a relatively unstable relationship to the SDR interest rate, partly because the Fund's holdings of currency subject to charges and the creditor positions on which remuneration is paid (and which reflect the cost of financing the Fund's administrative expense) vary in relation to one another, though normally the balances subject to charge exceed the total of balances on which remuneration is paid. Furthermore, as pointed out above, the Fund receives substantial income from its holdings of SDRs, and the lower the SDR interest rate, the lower the Fund's income and vice versa.

Thirdly, Directors have also recently noted that given the present link between the SDR interest rate and the rate of remuneration, it has become increasingly difficult to implement the burden sharing and extended burden sharing decisions as originally intended. Difficulties have arisen in financing the SCA-2 in the intended proportions, partly because the rate of remuneration has reached the 80 percent floor in terms of the SDR interest rate and partly because of the relatively low level of the SDR interest rate. Furthermore, under present arrangements, it would be difficult to

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1/ As noted above, the distribution of nonremunerated reserve tranche positions is uneven among members and essentially reflects the distribution of quotas at the coming into effect of the Second Amendment of the Articles in April 1978, and, in the light of Article V, Section 9, it is not legally possible to harmonize members' positions in the Fund by taking into account their nonremunerated positions.

extend burden sharing further, if that were desired by the Executive Board--for example, to burden share the net income target--because there is no further room to reduce the rate of remuneration in terms of the SDR interest rate, or, indeed, more generally, to use the rate of remuneration as a variable in determining the Fund's rate of charge. The close link between the SDR interest rate and the rate of remuneration has the effect of introducing an important rigidity in the implementation of burden sharing. More generally, it limits the Fund's range of financial policy instruments at its disposal.

In short, the present methods used to finance the costs of operating the Fund are relatively few; they fall unevenly on individual members and depend on the level of their involvement in the Fund's operations and transactions; they give rise to relative instability of the rate of charge, and they are somewhat inflexible in meeting new costs. Furthermore, the distribution of the cost of financing the Fund is not transparent between the two major groups of members. As a consequence, a number of Directors have requested consideration of alternative means of financing the cost of operating the Fund. In addition, a number of Directors have requested that any new system of financing the cost of operating the Fund be more "equitable" than the present system. It is difficult to define equity--which is essentially a matter of judgment--but it would be reasonable to attempt to derive a comprehensive system that would be widely perceived to be broadly fair in the sense that members of vastly different economic size and of financing ability would contribute in some given measure to the financing of the cost of operating the Fund. There is no single key that would in all likelihood be generally acceptable in governing the distribution of the costs of financing the Fund. The issue that arises is whether there would be general agreement to achieve a wide distribution that would include all Fund members in financing the cost of administrating the Fund and of the target amount of net income (i.e., the addition to the Fund's reserves).

III. Alternative Ways of Financing the Fund's Expenses

This section considers alternative ways of financing the Fund's expenses, and in particular the financing of the Fund's administrative expenditures and additions to the Fund's precautionary balances, including the net income target. Two main issues have arisen in the past: (i) whether under the present system, too large a share of the cost of financing the Fund's operations is borne by those members making use of the Fund's resources, which may discourage members from adopting appropriate adjustment policies and (ii) what other mechanisms for distributing the financing of the Fund's costs can be considered within the framework of the present Articles of Agreement, or after a further amendment of the Articles. As regards (i), it has been pointed out above that, while the Fund's operational income (charges) covers its operational expense (remuneration and interest on borrowing), the contributions of creditors and debtors in covering the cost of the Fund's administrative expenses and the build-up of its precautionary balances is broadly equal at the present time not only because of the burden sharing arrangements but also because of the

importance of the nonremunerated reserve tranche positions, the distribution of which is uneven among present creditors. However, the burden sharing arrangements are temporary and the size and distribution of the non-remunerated reserve tranches can change substantially over a relatively short time. The second set of questions relating to (ii) is taken up in the following paragraphs.

1. Changes within the framework of the present Articles

In principle, consideration could be given, without amending the Articles, to change the distribution of financing the costs of operating the Fund in any or all of the three following ways:

a. Extension of burden sharing to cover administrative expenses and net income target

First, if the Executive Board agreed, it would be technically possible to include the cost of the Fund's administrative expense and the addition to the Fund's reserves--i.e., the Fund's net income target--within a more broadly defined burden sharing arrangement. This would mean including these two costs in the calculation of the amount to be paid by reducing the rate of remuneration as well as increasing the rate of charge to yield an equal amount of resources. As noted earlier, the rate of remuneration is presently at its floor in terms of the SDR interest rate. However, as the SDR interest rate increases, the amount of the burden sharing that could be financed from a reduced rate of remuneration would in general increase.

Table 4 below shows what would have been the impact over the last three financial years of including in the burden sharing arrangements the cost of the Fund's administrative expense and the Fund's net income. It is assumed that these two additional costs would have been burden shared equally through a reduction in the rate of remuneration and an increase in the rate of charge; it is further assumed that the existing burden shared costs (deferred income, SCA-1, and SCA-2) would continue.

As can be seen from Table 4, the rate of charge would have been lower by, on average 190 basis points. As regards remuneration, the floor to the rate of remuneration of 80 percent of the SDR interest rate would have come into effect much sooner than has been the case, and it would not have been possible to finance the creditors' share to the SCA-2 in the intended proportions virtually since the establishment of the SCA-2 in mid-1990. As a consequence, the level of the Fund's precautionary balances (including SCA-2) would have been below the present level by approximately SDR 130 million. Furthermore, the burden sharing arrangements would continue to exclude those members which hold a neutral position in the Fund, i.e., those members that have no outstanding use of the Fund's resources nor an outstanding reserve position in the Fund. Nevertheless, such a redistribution of the financing of two relatively large cost items in running the Fund would importantly redistribute the financing of the costs of operating the Fund as between debtors and creditors.

Table 4. Comparison of Present Burden Sharing Mechanism to Alternative Method of Including Net Income and Administrative Expenses
FY 1991-1993

(in millions of SDRs and in percent)

	FY 1991			FY 1992			FY 1993		
	Actual	Alternative Method 1/	Difference	Actual	Alternative Method 1/	Difference	Actual	Alternative Method 1/	Difference
Rate of charge									
Basic	7.65	5.84	-1.81	6.88	4.93	-1.95	5.60	3.76	-1.84
B/S adjustment	1.27	2.92	1.65	1.14	3.01	1.87	0.95	2.59	1.64
Adjusted	8.92	8.76	-0.16	8.02	7.94	-0.08	6.55	6.35	-0.20
Rate of remuneration									
Basic	8.79	8.79	--	7.12	7.12	--	5.72	5.72	--
B/S adjustment	1.61	1.75	0.14	1.43	1.43	--	1.14	1.14	--
Adjusted	7.18	7.04	-0.14	5.69	5.69	--	4.58	4.58	--
Remuneration coefficient	81.68	80.00	-1.68	80.00	80.00	--	80.00	80.00	--
Debtors' contributions:									
Administrative expense	189.41			232.20			263.34		
Net income	69.85	297.04 2/		89.93	362.79 2/		70.57	336.43 2/	
Deferred charges	98.56			86.60			63.75		
SCA-1	34.93	34.93		36.67	36.67		38.92	38.92	
SCA-2	41.74	41.74		57.90	57.90		63.20	63.20	
	434.49	373.71	-60.78	503.30	457.36	-45.94	499.78	438.55	-61.23
Creditors' contributions:									
Administrative expense	--			--			--		
Net income	--	159.34 2/		--	132.54 2/		--	124.98 2/	
Deferred charges	98.56			86.60			63.75		
SCA-1	34.93	34.93		36.67	36.67		38.92	38.92	
SCA-2	100.55	66.14		98.42	58.19		113.81	56.63	
	234.04	260.41	26.37	221.69	227.40	5.71	216.48	220.53	4.05
Total contributions	668.52	634.11	-34.41	724.99	684.76	-40.23	716.26	659.08	-57.18

1/ Items subject to burden sharing include deferred charges, net income and administrative expenses.
2/ Administrative expense, net income and deferred charges combined. The adjustments for these items and SCA-1 cannot reduce the rate of remuneration to below 85% of the SDR interest rate. Amounts causing the adjustments to the rate of remuneration to exceed that limit are assumed to be borne by the debtors.

b. Charge for operating administered accounts

The Second Amendment of the Articles enabled the Fund to perform financial or technical services that are not on account of the Fund, if requested, and provided they are consistent with its purposes. The financial services include the administration of resources contributed by members or by others, and the technical services include technical assistance within the Fund's sphere of interest. The Fund has not adopted an explicit policy of charging for these services, but, on an ad hoc basis, has in fact charged for conducting the operations for the Trust Fund and the operations for the SAF and ESAF. The Fund did not charge for operating the Oil Facility Subsidy Account or the SFF Subsidy Account, nor has it charged for the ad hoc administered accounts established at the request of individual members mainly to assist them in the clearing of arrears (including to the Fund), as, for example, for Bolivia, Panama, and Guyana. 1/ Similarly, the Fund has not generally charged, in connection with the establishment of administered accounts, for the administration of technical assistance - though the Fund receives a contribution of 13 percent of total outlays to cover overheads in connection with the administration of technical assistance financed by the UNDP and the Technical Assistance Account - Japan.

The staff resources involved in establishing these administered accounts are often relatively large. The actual administration of the accounts is also relatively labor-intensive. In view of these costs, it is for consideration whether the Fund should levy a charge for these services. At present the costs of establishing and administering the accounts are borne by the administrative budget and therefore affect the rate of charge. However, while a levy set, for example, as a percentage of the capital value of the administered account could reasonably cover the Fund's costs, it could deter members from requesting these services or severely curtail such requests, even though these instruments have been helpful in furthering the Fund's interests.

c. Charge for technical assistance provided by the Fund

The provision of technical assistance by the Fund has grown rapidly during the 1990s. In terms of manpower used, technical assistance has increased from 170 person-years in FY 1990 to 244 person-years in FY 1993 and a projected 301 person-years in FY 1994. 2/

It has long been the Fund's policy to require a contribution from recipient countries toward the cost of assignment of a long-term technical expert, with the twin objectives of defraying part of the cost and of encouraging an economical attitude toward making requests for technical

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1/ The administered account technique was not used in the arrears clearance operations for Peru, Viet Nam, or Cambodia, though the staff's involvement in these operations was relatively large.

2/ See *Review of Fund Technical Assistance*, EBAP/93/78 (12/1/93).

assistance. Generally, the contribution has taken the form of a cash payment graduated according to the country's ability to pay, and in FY 1993, cash contributions from recipient countries totaled SDR 0.6 million. In addition, a considerable proportion of the Fund's technical assistance programs was financed from "external" sources, in particular, the UNDP and Japan (JAA). However, as noted in EBAP/93/78, the scope for mobilizing additional external financing over the short to medium term appears to be limited.

It is for consideration whether the Fund should increase the contributions made by recipient countries to the cost of technical assistance provided by the Fund. No doubt, the scale of contributions by recipient countries would need to be graduated, say, on the basis of per capita income. However, the Fund's decision to subsidize technical assistance could be made explicit in the administrative budget, and the membership as a whole would be in a position to make an informed decision on the level of subsidization it wished to finance.

The arguments relating to the provision of technical assistance have been spelled out elsewhere and the impact of "full" or "other" cost financing is not certain either on the demand for the Fund's technical assistance nor, indeed, as regards the services that the Fund can provide to its membership in furtherance of its role in the international monetary system. This issue will be further explored by the Committee on the Budget.

2. Changes in financing arrangements that would involve amending the Articles

If consideration were to be given to introduce fundamental changes in the system of financing the Fund's operations and in particular if it were considered desirable to seek a comprehensive system of financing the Fund, then consideration would need to be given to introduce amendments to the Articles of Agreement. This would be a difficult and complex process, given the many interrelationships among the various Articles regarding the financing of the Fund. The following subsections present three types of amendments that could be considered. If Executive Directors decide that any of these possibilities deserve further consideration, the complex ramifications of such suggestions would need to be worked out subsequently and in greater detail.

a. Reimbursement of the costs of conducting the GRA

A partial approach to meet the cost of financing the Fund would be to consider levying an annual assessment, payable in SDRs, to meet the expenses of conducting the business of the GRA. The assessment could be levied in proportion to members' quotas, and would need to be paid in SDRs, rather than in the member's own currency in order to avoid a reduction in the Fund's holdings of currency which would either reduce the Fund's income from charges or increase its remuneration expense, thereby leaving the net financial position of the Fund unchanged. Such an assessment would be analogous to that levied on participants in the SDR Department, which is

levied in proportion to members' net cumulative allocation of SDRs, to meet the costs of conducting the business of the SDR Department.

The decision, provided by the first Amendment of the Articles in 1969, to levy an assessment on participants in the SDR Department reflected both the separation of the assets and, in general, the operations of the SDR Department from the General Department. Furthermore, while SDRs were issued by the Fund, the holding of SDRs did not confer on participants a claim against the Fund itself, but would instead enable participants to use their SDRs in operations and transactions with other participants and, for specific purposes, with the GRA. In addition, it was decided to set the rate of charge on the use of SDRs equal to the rate of interest on holdings of SDRs so that aggregate charges and interest would exactly cancel out and there would be no profit or loss in the SDR Department, so that the GRA would have to absorb the costs of operating the SDR scheme in the absence of an assessment. However, it was also agreed that those Fund members which chose not to participate in the SDR scheme should not have to pay for its cost of operation. Consequently, a selective assessment was introduced which applied only to participants in the SDR Department, and, as mentioned above, it was set in proportion to participants' net cumulative SDR allocations. The proportionate assessment was based on the argument that it was in the common interest of all participants--and perhaps especially of those being allocated the most SDRs--for the overall scheme to work properly and equitably. 1/

The main advantage of such an assessment in the GRA is that it would include all members in financing the Fund, rather, as at present, only some members, in particular the users of Fund resources. However, a considerable number of difficulties arise. First, it would be important to define the actual costs that would be covered by the assessment, particularly, in view of the fact that the current service charge and commitment fees charged on users of the Fund's resources are intended to cover a share of the costs incurred in the GRA. It would be important to avoid double charging the debtors, even if it would be possible to separate out the costs incurred directly by the GRA in carrying out its operations and transactions (which would be covered by the existing financing arrangements) and the other functions of the Fund - such as technical assistance, surveillance, information, and public relations activities.

Second, an important consequence of such an amendment would be that an assessment on members in proportion to their quotas could be expected to require the approval of parliaments for making such payments to the Fund for

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1/ The possibility of levying a fee on transactions in the SDR Department was specifically excluded during the discussions leading up to the First Amendment of the Articles. This approach was rejected partly because it was not certain how much such a fee would yield; it was also thought that it would be inconsistent to levy such a fee at the same time that it was proposed to eliminate the transactions fee on gold tranche drawings in the GRA.

those countries that need such approval to make their contributions or subscriptions to international organizations. A further consequence would be that recourse to members' contributions for financing the Fund's budget would give the UN grounds to terminate the exemption for the Fund from the review of the Fund's annual administrative budget by the General Assembly of the United Nations, pursuant to Article 17, paragraph 3 of the UN Charter. 1/ The UN agreed in 1947 that the administrative budget of the Fund would not be subject to this procedure because the Fund does not rely for its annual budget on contributions from members. As a consequence, the General Assembly would become involved in the conduct of the Fund's activities.

b. Break of the link between the rate of remuneration and the SDR interest rate

The largest element of the financial cost of operating the Fund is the payment of remuneration on the use of members' currencies in excess of the nonremunerated reserve tranche positions, and the payment of interest on borrowing. As mentioned earlier, the Articles of Agreement prescribe that the rate at which remuneration is paid shall be not less than 80 percent of the interest rate on the SDR, and not more than the SDR interest rate (Article V, Section 9). At present, the basic rate of remuneration--that is, the rate before the adjustments agreed under the decisions on burden sharing--is set equal to the SDR interest rate under Rule I-10. However, the rate of remuneration actually paid is reduced by the adjustments under burden sharing; the adjusted rate in fact has been at the minimum of 80 percent of the SDR interest rate since August 1990, i.e., shortly after the adoption of extended burden sharing and the start of SCA-2.

In present circumstances--that is, given the amount of deferred charges, the agreed rates of contributions to the Special Contingent Accounts, and the present level of the SDR interest rate 2/--the floor to the rate of remuneration would not allow a different distribution of the cost of operating the Fund. Furthermore, the narrowing of the spread between the rate of remuneration and the SDR interest rate effectively limits the use of the rate of remuneration as a variable in determining the Fund's financial policies, e.g., by taking into account the rate of charge

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1/ Article 17, paragraph 3 of the UN Charter provides: "The General Assembly shall consider and approve any financial and budgetary arrangements with specialized agencies referred to in Article 57 and shall examine the administrative budgets of such specialized agencies with a view to making recommendations to the agencies concerned."

2/ The amount that can be generated by a reduction of the rate of remuneration is severely affected by the level of the SDR interest rate: given present remunerated balances of about SDR 23.3 billion, a reduction of the rate of remuneration of 20 percent (from say 3.85 percent to 3.08 percent) saves the Fund remuneration expenses of about SDR 180 million; at the SDR interest rate in effect at the time of the adoption of extended burden sharing (of about 7.0 percent), the saving would be about SDR 325 million.

in determining the rate of remuneration (as would be possible under the present Articles) or, indeed, in limiting the volatility in the rate of remuneration (and the rate of charge) because of volatility in the SDR interest rate resulting from changes in short-term interest rates in the major money markets of the world. To make a different distribution of the Fund's operating and administrative costs possible, or to use the rate of remuneration as a policy variable, it would be necessary either to break the link between the rate of remuneration and the SDR interest rate, or to reduce the lower limit to the remuneration coefficient. 1/ Either course of action would require an amendment of Article V, Section 9.

While a reduction or elimination of the floor to the rate of remuneration would permit a different distribution of operating cost among the Fund's debtor and creditor member countries, that distribution would continue to be based on remunerated (and, by implication, on nonremunerated) balances; it would not provide for the possibility of a distribution that would, for example, more closely align the financing of operating the Fund to members' quotas in the institution.

3. Uniform norm and nonremunerated positions

The difference in nonremunerated positions in relation to quotas, as related to members' remuneration norms discussed above (Section 5(b)), implies that creditor members' contributions to the financing of the Fund which are based on remunerated positions would continue to diverge from a distribution that more closely reflected members' participation in the Fund

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1/ It may be noted that the original Articles made no provision for remuneration per se, but Article XII, Section 6 did provide for the Board of Governors to decide annually what part of the Fund's net income would be placed to reserves and what part, if any, would be distributed. The Fund made preferential distributions of net income to members only in the financial years 1968 and 1969, in amounts equal to 1 1/2 percent of net creditor positions, while no nonpreferential distributions were ever made. As a consequence of the First Amendment of the Articles, the Fund was required to pay remuneration on members' net creditor positions (i.e., when holdings of currency were below 75 percent of quota) and the SDR interest rate was set equal to the rate of remuneration, reflecting the view that yields on similar Fund-related assets should be essentially the same. The Fund in its discretion could increase or reduce the interest on the SDR, but the rate could not be greater than 2 percent or the rate of remuneration, whichever was the higher, or smaller than 1 percent or the rate of remuneration, whichever was lower. The Second Amendment of the Articles reversed this relationship, partly on the grounds of the objective of making the SDR the principal reserve asset of the system, and the rate of remuneration was to be set in relation to the SDR interest rate, and permitted to vary within the range of 80 and 100 percent of the SDR interest rate. The Articles provided for this margin partly because in establishing the rate of remuneration, the Fund shall take into account the rate of charge on the use of the Fund's resources.

as measured by their quotas. Such a distribution has been suggested by a number of Executive Directors. The Articles of Agreement provide for the possibility of an equiproportional increase in members' norms for remuneration, but not for a decrease. Such an increase presumably would contribute toward a "more equitable" distribution among creditor countries of the cost of financing the Fund; however, it would at the same time increase these costs by raising the amount of remunerated balances. Moreover, it would not contribute toward linking the contributions of debtor countries to their quotas.

To achieve a more "equitable" distribution while taking these constraints into account, consideration could be given to establish a common norm below 100 percent for all member countries. In order to ensure that all members, debtors and creditors and "neutrally positioned" members alike, indeed contributed to the financing of the Fund's operations, it would be necessary to ensure that these nonremunerated positions remained available to the Fund and could be further enlarged to meet increased costs of operating the Fund. 1/ To meet these twin objectives, the common norm would have to be set at some agreed level below 100 percent, and all members--including members that currently are making use of the Fund's resources--would have to maintain an agreed level of nonremunerated positions. 2/ The common norm would need to be adjustable, and would be set anew each year in light of the total expenditures that are to be financed this way. 3/ While conceptually and practically there would not appear to be major difficulties in administering such a system, such a system would not be possible under the existing Articles of Agreement, and hence also would require an amendment of the Articles. Such a system could be comprehensive and could include all costs of financing the Fund, and in principle could work in much the same way as if a levy were imposed on each member in proportion to its quota.

IV. Summary and Conclusions

The following are the main conclusions of the above discussion:

1. The cost of operating the Fund falls into two broad categories: (i) its operational expenses, which are composed of remuneration payments to those members whose currencies have been sold on a net basis by the Fund and whose currencies have been used in making administrative payments, and

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1/ See, for example, Mr. Wright's comments on, and additions to, Mr. Posthumus' proposal at Executive Board Seminar 92/1 (7/8/92).

2/ The possible operation of such a system has been summarized in *Cost of Fund Credit--Principles of Burden Sharing--Concessionality in Fund Operations, and Related Matters--Background Material*, EBS/92/108, Sup. 1 (6/15/92), Note 5. See also Executive Board Seminar 92/1 (7/8/92).

3/ Under Mr. Posthumus' proposal, these were to be administrative costs and the costs associated with overdue obligations. See Grey Document 92/4 (2/14/92).

interest on Fund borrowing and (ii) the Fund's administrative expenses and the financing of its precautionary balances--i.e., the net income target, payments to cover deferred charges, and contributions to the Special Contingent Accounts.

2. The Fund's expenses can be financed in three ways, viz, (i) by levying charges on the use of its resources; (ii) by reducing remuneration expense, through reducing the rate of remuneration, subject to it not falling below 80 percent of the SDR interest rate; and (iii) by levying fees and assessments on sundry services that it renders to members. The Fund's rate of charge, given a particular amount of interest-free resources, is set prospectively so as to cover all of the Fund's operational and administrative expenses and target net income. In addition, the Fund's income from charges and the resources derived from the reduction in the rate of remuneration are also intended to finance the cost of overdue obligations. The Fund's incomes from fees and assessments are small and derive basically from the assessment levied on participants to cover the cost of conducting the SDR Department and also the recovery of costs in connection with operating the SAF and ESAF.

3. In addition to these income-related resources, the Fund has available a substantial amount of interest-free resources which have the overall effect of lowering the Fund's cost structure significantly, and which thereby effectively reduce the Fund's administrative and operational expenses. The Fund's interest-free resources derive essentially from nonremunerated creditor positions, the Fund's reserves (including past sales of gold) and other precautionary balances held in the GRA. In practice it is not possible to attribute the benefit of the Fund's interest-free resources to any specific category of the Fund's expenditures, e.g., the administrative budget.

4. The distribution of the cost of financing the Fund, taking into account the Fund's income target, the burden sharing arrangements, and the Fund's interest-free resources, essentially shows that the Fund's operational income (from charges) finances the Fund's operational expenses (mainly remuneration and interest expense), while the financing of the Fund's administrative expenses and its precautionary balances (deferred income and SCA-1 and SCA-2) are spread approximately equally between debtor and creditor members through income from charges and reduced remuneration arising from burden sharing and the nonremunerated reserve tranches. The Fund has no investment income. The overall incidence of the cost of financing the Fund under present arrangements is not skewed, but neither is it transparent.

5. A number of criticisms have been aimed at the present financing arrangements, and in particular at the fact that these arrangements are based on members' operations and transactions with the Fund and the rate of return on their Fund positions. This system therefore leaves out of the financing arrangements those members that have not used the Fund's resources nor participated in financing the Fund through the operational budget. Furthermore, the distribution of members' creditor positions, in particular

the nonremunerated reserve tranche positions, reflects the nature of subscriptions until the Second Amendment and the increases in quotas thereafter. The nonremunerated reserve tranche positions cannot be taken into account in allocating currencies in the operational budget. In the view of some Directors this leads to inequities in the allocation of reserve positions among the creditor countries as well as between creditors and debtors. Some Directors have thus concluded that a different basis for financing the Fund's operations and transactions should be considered, e.g., on the basis of members' quotas in the Fund.

A number of Directors have also noted that the rate of charge fluctuates quite sharply around the SDR interest rate, which itself is a relatively volatile market-related interest rate, and thus is a source of instability in the Fund's financing arrangements, and sometimes leads to a relatively high rate of charge, given the link to the market-determined SDR interest rate. Furthermore, given the close link between the SDR interest rate and the rate of remuneration, it has become difficult to implement the burden sharing decisions as intended so that difficulties have arisen in the financing of these arrangements (in particular to maintain the intended proportions for contributing to the SCA-2).

6. In the light of the working of the present system of financing the Fund, a number of Directors have requested consideration of alternative means of financing the cost of operating the Fund. In particular they have asked whether a new comprehensive system of financing the cost of operating the Fund might be developed that would be more "equitable" and transparent than the present system. A number of alternative ways of financing the cost of operating the Fund have been briefly discussed, some of which could be implemented within the framework of the present Articles whilst other more radical alternatives could be considered only within the framework of an appropriate amendment of the Articles of Agreement.

7. Three suggestions have been proposed for the consideration of the Executive Board which could be introduced without amending the Articles:

a. consideration could be given to include the cost of financing the administrative budget and the net income target within the current burden sharing arrangements. These two costs would then be included in the calculation as regards that part of burden sharing to be paid for by reducing remuneration and that part which would be financed through increasing the rate of charge to yield equal amounts of resources. Such a scheme would of course be effective provided only that the rate of remuneration would not fall below its floor of 80 percent of the SDR interest rate. Furthermore, this system of financing is an extension of the present system which is based on members' operations and transactions with the Fund, and while it would change the distribution of the cost of financing between the debtors and creditors, it would not, of itself, extend the system of financing to all members on the basis of a comprehensive standard;

b. consideration could also be given to a charge for operating administered accounts established at the request of members; and

c. consideration could be given to widening the range and the level of charges for technical assistance provided by the Fund, or to increase resources provided by external sources for this service.

8. The changes in the system of financing the Fund that could be achieved under the present Articles are essentially limited and could be directed only to those members using the Fund's resources (charges) or requesting its services (fees) or to those members that effectively supply the Fund with usable resources (adjustments in the rate of remuneration, subject to it not falling below 80 percent of the SDR interest rate). Relatively little change could be introduced that would introduce a new standard of financing or include those members that hold "neutral" positions in the Fund. There is also little financial advantage in investing some part--which would be limited to the size of the Fund's reserves--of the Fund's currency holdings for income purposes because the rate of return on such investments is unlikely to exceed the cost of remuneration that the Fund would incur as a result of such investments.

9. If it were desired to consider changes in the Fund's financing arrangements that would call for an amendment of the Articles, the following three schemes could be considered further:

a. the reimbursement of the costs of conducting the business of the GRA, e.g., by levying a charge payable in SDRs on the basis of members' quotas. Such a charge would be analogous to the assessment levied on participants in the SDR Department, which is levied in proportion to participants' net cumulative allocation of SDRs, and is fixed at a level which is estimated to meet the costs of operating the SDR Department. This scheme would raise serious issues for the Fund - in particular, members that need approval of parliament for their annual appropriations for international organizations could be expected to need such approval for the amount of the assessment and this would also have implications for the Fund's relationship with the UN. In particular, it would raise the issue of subjecting the Fund's administrative budget to a regular budgetary review by the UN General Assembly;

b. difficulties have arisen in implementing the burden sharing arrangements, and there are arguments in favor of extending the burden sharing arrangements over a wider area of the Fund's expenditures. With this in mind, consideration could be given either to break the link between the rate of remuneration and the SDR interest rate so that the rate of remuneration would not be subject to a floor in terms of the SDR interest rate, or to lower the floor to the rate of remuneration. The Fund could then exercise a policy-related discretion when fixing the rate of remuneration periodically, which would take into account all relevant circumstances, including the rate of charge on the use of the Fund's resources, as is already provided in the Articles. Furthermore, the rate of remuneration, and hence the rate of charge on the use of the Fund's resources, would not

be so tightly linked to the SDR interest rate and hence to the level of short-term interest rates in the five major money markets in the world; and

c. as proposed earlier by some Executive Directors consideration could also be given to first equalize the norm for remuneration at 100 percent of quota and then periodically reduce the norm for remuneration for all members, which would thereby establish a norm of less than 100 percent of quota for all member countries by an amount that would cover the cost of financing the Fund. This would ensure that all members would contribute to the financing of the Fund's operations, provided members agreed to maintain a certain level of nonremunerated position in the Fund. In principle, such a system would work in the same manner as if a levy were imposed on each member in proportion to its quota.