FOR AGENDA

EBS/86/258

CONFIDENTIAL

November 21, 1986

To: Members of the Executive Board

From: The Acting Secretary

Subject: Midyear Review of the Fund's Income Position

Attached for consideration by the Executive Directors is a paper on the midyear review of the Fund's income position for the first six months of FY 1987, which is scheduled for discussion on Friday, December 12, 1986.

Mr. Wittich (ext. 8307) or Mr. R. B. Hicks (ext. 7822) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

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INTERNATIONAL MONETARY FUND

Midyear Review of the Fund's Income Position

Prepared by the Treasurer's Department

Approved by W.O. Habermeier

November 21, 1986

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I. Introduction

In accordance with Rule I-6(4)(b), the Executive Board regularly reviews the Fund's income position after the completion of the first six months of the financial year. Such a review continues to be called for under the recent adaptation of the method of determining the rate of charge and of the rate of remuneration in the light of the impact on the Fund's income position of overdue obligations. 1/ The present paper is intended to serve as a basis for this review. The following section discusses income realized in the first six months of the financial year, and revised estimates for the year as a whole are presented in Section III. Possible courses of action are considered in Section IV, and a concluding section summarizes the main points of the paper.

II. The First Half of FY 1987

Under the procedures for determining the rates of charge and remuneration for FY 1987 and FY 1988 agreed earlier this year, the Executive Board determines at the beginning of the financial year a "basic" rate of charge on the basis of projected income for the year and excluding the effect of any need to defer charges. If income from charges becomes deferred during a six-month period, the rate of charge and, subject to certain limitations, the rate of remuneration for that period are adjusted accordingly. One half of the net amount of deferred charges is financed by an increase in the rate of charge, and the other half by a simultaneous reduction in remuneration payments. The decision prescribes that the amounts collected as adjustment (and the remuneration not paid) shall be paid when and to the extent that deferred charges that gave rise to the adjustment are settled to members that paid adjusted charges or received reduced remuneration. The adjustment of charges (and the reduction in remuneration payments) accordingly is based on the net new amount of charges deferred during the semiannual adjustment periods. 2/

In accordance with this provision, the "basic" rate of charge which had been set at 6 percent as of the beginning of FY 1987 was adjusted to 6.39 percent for the first half of the financial year, and the rate of remuneration reduced commensurately. 3/

1/ Executive Board Decision No. 8348-(86/122) adopted July 25, 1986 on "Principles of 'Burden Sharing', the Income Target for FY 1987 and FY 1988, the Rate of Charge, and the Rate of Remuneration". For ease of reference, this Decision and Rule I-6(4) are attached in the Appendix.

2/ See Executive Board Decision No. 8348-(86/122), Section V. The term "'basic' rate of charge" is not used in this Decision, but for shortness and ease of exposition is used in the present paper to denote the rate that does not include an allowance for deferred charges, in contrast to the "adjusted" rate of charge, which does.

3/ See Executive Board Decision No. 8349-(86/122) adopted July 25, 1986 and "Adjustment of the Rate of Charge and the Rate of Remuneration for the First Half of FY 1987" (EBS/86/242, 11/4/86).

Table 1. Projected Income and Expense
Financial Year 1987

(In millions of SDRs)

	Initial Projections 1/ First Half FY 1987	Initial Projections 1/ FY 1987	Actual First Half FY 1987	Difference between Projected and Actual First Half FY 1987	Revised Projections FY 1987
1. Operational Income					
a. Periodic charges:					
Regular facilities	596	1,171	567	-29	1,133
SFF	190	346	187	-3	334
EAR	447	902	371	-76	735
	1,233	2,419	1,125	-108	2,202
Addition to periodic charges			37	37	37
Special charges			5	5	5
	1,233	2,419	1,167	-66	2,244
Deduct - Income deferred			-57	-57	-57
	1,233	2,419	1,110	-123	2,187
b. Interest on SDR holdings	70	116	81	11	135
c. Other income:					
Regular facilities	11	20	5	-6	22
EAR	4	8	2	-2	7
Total other income	15	28	7	-8	29
Total operational income	1,318	2,563	1,198	-120	2,351
2. Operational Expense					
a. Remuneration	607	1,173	581	-26	1,140
Reduction of remuneration	-7	-14	-44	-37	-51
	600	1,159	537	-63	1,089
b. Interest expense					
SFF	173	312	169	-4	299
EAR	398	804	321	-77	637
Total interest expense	571	1,116	490	-81	936
Total operational expense	1,171	2,275	1,027	-144	2,025
3. Net operational income	147	288	171	24	326
4. Administrative expense	102	204	100	-2	198
5. Net income	45	84	71	26	128

1/ Based on the assumptions set out in "The Fund's Net Income for FY 1986 and FY 1987 and Determination of the Rate of Charge for FY 1987" (EBS/86/116, 5/28/86), but adjusted for the reduction of the rate of charge from 7.00 percent used for the projections in that paper to 6.00 percent.

Taking into account the adjusted rate of charge, the Fund's income for the period ended October 31, 1986 is SDR 71 million, or SDR 26 million above the target amount of SDR 45 million projected at the beginning of the financial year (Table 1). The excess of actual income over the amount projected at the beginning of the year reflects mainly the settlement of charges that had been deferred before May 1, 1986 and the change in market interest rates that determine the SDR interest rate and the rate of remuneration. The other main factors affecting Fund income had a lesser impact and did not lead to an outcome that is substantially different from the projections made at the beginning of the year. The net effect on net income of the major factors can be summarized as follows:

Table 2. Explanation of Difference Between Projected and Actual Net Income for the First Half of FY 1987

(In millions of SDRs)

Projected net income	45
Actual net income	71
Increase	26
Attributable to:	
(a) Settlement of income deferred in prior year	20
(b) SDR interest rate and rate of remuneration below projected values	12
(c) SDR value of administrative expenses below projection	2
(d) Purchases below projections	(8)
(e) Other - net	--
	26

The reasons for the deviations were as follows:

(a) Four members settled SDR 20.3 million of charges deferred in FY 1986 during the period May-October 1986. It will be recalled that since the adoption of burden sharing the income projections no longer include a projection of deferred charges or of the settlement of deferred charges. These settlements are reflected in the excess of

actual income over projections. 1/ Charges deferred during the first six months of FY 1987 amounted to SDR 73.1 million and, as mentioned, gave rise to an increase of 39 basis points (from 6.0 percent to 6.39 percent) in the rate of charge and a reduction of 38 basis points in the average rate of remuneration over the first half of the financial year. 2/ The total of deferred income at October 31, 1986 amounted to SDR 179.9 million compared to SDR 127.0 million at the end of FY 1986. Of the current balance of SDR 179.9 million of deferred charges, an amount of SDR 73.1 million will accrue to the members that paid an adjusted rate of charge or received reduced remuneration when and to the extent that these overdue charges are settled. 3/

(b) The SDR interest rate averaged 6.04 percent over the first six months of the financial year, compared to 6.2 percent projected at the beginning of the year. As a result, the average (basic) rate of remuneration at 5.89 percent was about 15 basis points lower than the projected average rate of 6.04 percent, and remuneration expense and interest earned on SDR holdings were lower by SDR 14.8 million and SDR 2.1 million lower than had been projected.

(c) Mainly as a result of lower than projected purchases under arrangements and the CFF, average balances subject to charges were SDR 945 million (4.8 percent) below the projected level, average SDR holdings above those expected by about SDR 407 million, and average remunerated balances and average balances of outstanding borrowing lower by SDR 384 million and SDR 288 million, respectively, than anticipated. Since the difference between the rate of charge and the cost of resources (the rate of remuneration or the SDR interest rate) was small over the first half of FY 1987, the effect on net income of the delay in purchases was marginal, except for a shortfall of SDR 8 million resulting from the lower than expected income from service charges.

(d) Administrative expenses at midyear were about SDR 2 million lower than the projected level, reflecting mainly a decline in the U.S. dollar in terms of the SDR which reduced the SDR value of these expenses.

1/ The settlement of deferred charges reduced the amount of income deferred before introduction of the system of sharing the cost of overdue obligations among debtor and creditor member countries and still outstanding from SDR 127.0 million to SDR 106.7 million. It will be recalled that no decision has been taken on the treatment of net income deriving from the settlement of charges deferred before May 1, 1986, which will accrue to general income of the Fund.

2/ See "Adjustment of the Rate of Charge and the Rate of Remuneration for the First Half of FY 1987" (EBS/86/242, 11/4/86).

3/ The amounts do not include special charges relating to FY 1987 that are deferred. Details of deferred charges are shown in Appendix Table 2.

III. Revised Estimates for FY 1987

1. Revised projections for FY 1987

The revised estimates for FY 1987, taking into account the actual results for the first six months of the financial year and the recent review of the likely use of Fund credit in the coming months indicate a further improvement for the Fund's income position. In addition to the impact on income in the first half of the year resulting from the collection of deferred income discussed in the preceding section, the improved outlook reflects primarily the reduction of the SDR interest rate since the beginning of the year. Assumptions underlying projections for the remainder of FY 1987 are set out in Appendix Table 1 and their effect is summarized in Table 3. The Fund's income is now projected at SDR 128 million, or SDR 44 million above the estimate made at the beginning of the year. While this represents a significant improvement in the income position, it is not very pronounced in comparison to the estimates of total operational income of SDR 2,351 million and expenditures of SDR 2,025 million.

Table 3. Explanation of Difference Between Original and Revised Projections of Net Income for FY 1987 1/

(In millions of SDRs)

Original estimate	84
Revised estimate	128
Increase	44
Attributable to:	
(a) SDR interest rate and rate of remuneration below projected values	21
(b) Settlement of income deferred in prior year	20
(c) SDR value of administrative expenses below projection	6
(d) Purchases below projections	--
(e) Other - net	(3)
	44

1/ Further details of the effect of differences between initial and revised estimates are shown in Appendix Table 3.

The main reasons for the deviations were as follows:

(a) SDR interest rate

It will be recalled that for purposes of the review of the Fund's income position, the SDR interest rate is projected to continue at the current level, rounded to the nearest one tenth. The SDR interest rate projected for the second half of FY 1987 thus is 6.0 percent, indicating an average interest rate for FY 1987 of 6.02 percent and a "basic" rate of remuneration of 5.91 percent, resulting in decreases of income from the Fund's SDR holdings and of remuneration expenditures of SDR 4 million and SDR 25 million, respectively. On balance, the decline of the SDR interest rate thus is projected to result in an increase in net income of SDR 21 million over the original projections.

(b) Deferred charges

Income from deferred charges are projected at the amount collected in the first half of the financial year, i.e., SDR 20 million. It will be recalled that the method chosen for sharing the cost of overdue payments among debtor and creditor countries included a (basic) rate of charge set on the assumption that there would be no new deferrals: adjustments for deferred charges would be made retrospectively based on charges that had actually been deferred. One of the reasons for adoption of that method was that the projections that had been attempted in the past, which made use of past deferrals and their settlement, had proved very unreliable. Accordingly, projected income no longer makes an allowance for newly deferred charges 1/ or for settlement of charges deferred in earlier periods. As mentioned earlier, the proceeds of the settlement of charges deferred after May 1, 1986 (i.e., in the first six months of FY 1987) would be paid to members that had borne the cost of the income deferral through an adjustment to charges paid or remuneration received. In contrast, the proceeds of a settlement of charges deferred before May 1, 1986 would increase Fund income for FY 1987 *pari passu*.

(c) Administrative expenses

Administrative expenses are estimated at US$242.8 million for the year. This converts into SDR 204 million for the year based on the average SDR/U.S. dollar rate for the first half of the year and on the

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1/ The maximum amount of charges (excluding special charges) that could be newly deferred in the second half of FY 1987 is SDR 262 million (see Appendix Table 2). The adjustment of the rates of charge and of remuneration necessary during the second half of the financial year to assure the net income target is about 5 basis points for each SDR 10 million of deferred income. The maximum adjustment that could become necessary is about 139 basis points, which would be called for only if no charges at all would be paid by any of the member countries presently on nonaccrual status or that could be on nonaccrual by the end of the financial year.

rate on October 31, 1986 for the remainder of the year. After deducting SDR 6 million for reimbursement of expenses of operating the SDR Department and the Special Disbursement Account, net administrative expenses are estimated at SDR 198 million. 1/

(d) Use of Fund credit

Projections made in connection with the recent assessment of the Fund's liquidity position indicate little change in the projected use of Fund resources estimated at the beginning of the year. 2/ Purchases of ordinary resources were then estimated to amount to about SDR 4.6 billion for the year, compared to the earlier estimate of about SDR 4.3 billion. In contrast, purchases under the policy on enlarged access were projected to be lower by about SDR 320 million than previously projected, approximately offsetting the projected increase in the use of ordinary resources. The net result on projected income is less than SDR 1 million. 3/ As mentioned, these projections are based on the staff review of likely use of Fund resources undertaken in August 1986. Developments since that review suggest the possibility of some delays in purchases beyond the dates expected earlier and thus some easing in new use of Fund resources during the remainder of the year. Some of these delays may involve substantial amounts, and would have an effect on charges and remuneration during the remainder of the year. However, as far as the Fund's net income is concerned, these effects are largely offsetting, except to the extent they reduce income from service charges in FY 1987 if purchases would be delayed beyond the end of the financial year.

(e) SDR holdings and remunerated balances

Average SDR balances are now projected higher by SDR 360 million than estimated earlier. Actual holdings are projected to be reduced from the present level of SDR 2.5 billion to the level of SDR 1.0 billion at May 31, 1987 in accordance with the decision on the level of the Fund's SDR holdings. 4/ Remunerated balances have been estimated

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1/ Projected administrative expenditures do not reflect the cost of an adjustment in staff compensation which is scheduled for consideration by the Executive Board on November 19, 1986 or of additional resources that may be required to meet the cost of the Early Retirement Assistance Scheme recently approved by the Executive Board. They also do not take into account reimbursement to the Administrative Budget of the cost, the amount of which has not been determined, of administering the Structural Adjustment Facility.

2/ See "Review of the Fund's Liquidity - Financing Needs and Financial Considerations for Access Policy in 1987" (EBS/86/187, 8/13/86).

3/ The projections do not take into account use of resources provided under the proposed new borrowing arrangement with Japan.

4/ See "Review of the Level of the Fund's SDR Holdings" (SM/86/70, 4/1/86).

as a residual taking into account expected purchases of ordinary resources and projected holdings of SDRs. Remuneration expense has been estimated on the basis of a remuneration coefficient of 97.49 percent for the third quarter of the financial year and of 100 percent starting February 1, 1987, as agreed in the decision on burden sharing. Projected remuneration expenditures do not take into account any adjustment in respect of new deferrals. 1/

2. Projected net income

On the basis of these assumptions, net income for FY 1987 as a whole is projected at SDR 128 million, or SDR 44 million above the net income target of SDR 84 million. 2/ As mentioned earlier, the amount of income in excess of the target, both that for the first half of the financial year and that projected for the whole year, primarily reflects the settlement of charges deferred before May 1, 1986 and the impact of the change in the SDR interest rate and the rate of remuneration.

3. Sensitivity of projected income to deviations from assumptions

The effect on net income of deviations from the assumptions underlying the projections are summarized in Appendix Table 4. Apart from the further settlement of charges deferred before the current financial year--which, as mentioned, would raise realized income pro tanto--realized income will again be affected most markedly by changes in the SDR rate of interest and, consequently, the rate of remuneration. Every change (increase or decrease) of the average SDR interest rate over the second half of the financial year by 10 basis points (i.e., from the projected level of 6.00 percent to 6.10 percent or 5.90 percent) will result in a decrease or increase (i.e., a change in the opposite direction) of net income by some SDR 8 million.

Net income is considerably less sensitive to deviation from projections of purchases (except for purchases in the unremunerated reserve tranche). The reason is that impact on net income reflects the margin between interest-costing balances (the use of SDRs or of reserve positions in the Fund that are remunerated) and interest-earning balances (reflecting the rate of charge), which at present is comparatively low. For example, a shortfall from projections (or an excess above them) of purchases in the unremunerated reserve tranche by 20 percent of the projected amount (or of about 45 million) would increase (decrease) net income by about SDR 0.7 million, while a shortfall (or excess) of purchases in the credit tranches or under the CFF by the same proportion (about SDR 700 million) would reduce (increase) net income by about SDR 4 million.

1/ Such adjustments would, of course, only offset lower income from charges, so that there would be no effect on the Fund's net income.
2/ See Table 1 above.

Other factors--e.g., the SDR value of administrative expenditures--are less likely to have a noticeable impact on the possible deviation of actual income from the projected level, and essentially follow random variations and therefore are more difficult to quantify.

IV. Possible Courses of Action

1. Background

The Executive Board has to review the Fund's income position shortly after the end of the first six months of the financial year with the aim of determining any action that might be necessary to ensure that the net income target for the year will be achieved. Rule I-6(4) and the decision on sharing the cost of overdue obligations prescribe that if actual income for the first six months falls short, on an annualized basis, of the net income target by 2 percent or more of the Fund's reserves at the beginning of the year, the Executive Board shall consider what action might be necessary; lacking an agreement by December 15, the rate of charge shall be set at such a level as is necessary to achieve the target amount of net income.

Actual income for the first six months of the financial year, on an annualized basis, exceeds the amount necessary to reach the target amount of net income and the projections for the year as a whole similarly indicate that the target is likely to be not only achieved but to be exceeded. In these circumstances, a consideration of measures to achieve the target is not called for, nor would the safeguard clause be activated which would automatically increase the rate of charge in the absence of an agreement.

It may be recalled that the now customary midyear review of the Fund's income position was first introduced in 1981 when the present method for setting the rate of charge was adopted. This review replaced an earlier rule that called for an automatic increase in the rate of charge if the Fund had incurred, or risked to incur, a deficit, but which had proved to lead to undesirable results. The main reason for instituting midyear reviews, and particularly for the safeguard clause of Rule I-10, accordingly was to contribute to achieving the net income target and to avoiding annual deficits. The reviews were not intended to lead to a more frequent adjustment of the rate of charge during the course of the year except in the case of a deficit; to the contrary, a substantial stability in that rate was considered desirable.

The Rules therefore do not call for an automatic adjustment of the rate of charge if the midyear review indicates the possibility or even likelihood of income in excess of the target. There has not been a midyear reduction in the rate of charge in years when revised projections indicated the possibility of income in excess of the target amount, although other considerations--such as uncertainty attaching to the projections, and the desirability of a somewhat faster accumulation of

reserves than indicated by the target amount--also played a role in deferring the adjustment.

2. Possible options

As discussed above, current projections indicate the possibility that net income will exceed the target amount, possibly by a substantial margin. It is therefore for consideration whether the Executive Board would wish to deal with the possibility of income in excess of the target amount at the present time. Possible courses of action, if the Executive Board would now wish to decide on the disposition of current and prospective income in excess of the target for FY 1987, would be:

(a) a reduction in the rate of charge for the remainder of the year, or for the year as a whole, to a level that would reduce projected net income to the target amount. On the basis of present projections, the net income target would be achieved with a reduction of the "basic" and the adjusted rates of charge for the year as a whole by 23 basis points, or by 47 basis points for the second half of the year. This would reduce the adjusted rate of charge for the first six months to 6.16 percent and call for a refund to the extent of the reduction of charges already paid, and call for a reduction in the "basic" rate of charge for the second half of the year only to 5.53 percent, respectively, with a corresponding lower adjusted rate than would otherwise obtain. Alternatively, it might be considered more prudent to base any reduction in the rate of charge on income in excess of the target realized during the first six months of the financial year, rather than on the projected excess. The reduction in the rate of charge would then be 14 basis points for the whole year or 27 basis points for the second half. A reduction of the rate of charge (which would require a decision taken with a majority of 70 percent of the voting power of the Executive Board) would be following the decline in market interest rates since the beginning of the financial year;

(b) an increase in the remuneration coefficient to 100 percent of the SDR interest rate retroactively to May 1, 1986 or as of November 1, 1986 rather than as of February 1, 1987 as will take place under Rule I-10. A retroactive increase with effect from May 1, 1986 of the rate of remuneration to equality with the SDR interest rate would reduce the excess of net income above target amount at midyear by SDR 15 million, while an increase in the coefficient as of November 1, 1986 would lower projected income for the year as a whole by SDR 7 million. Such an increase, which also would require 70 percent of the voting power, would achieve somewhat more quickly the agreed goal of raising the rate of remuneration to the SDR interest rate and thus closer to the return on other reserve assets;

(c) a combination of a reduction in the rate of charge and an increase in the remuneration coefficient in an agreed manner, e.g., by using to these ends equal amounts of excess net income;

(d) deeming the excess of income above the target as income for FY 1988, resulting in a correspondingly lower rate of charge in that year; and

(e) an increase in the amount of income that would be added to the Fund's reserves at the end of the year.

3. Balancing various considerations

The following factors would appear relevant in considering whether to deal with the current or prospective income in excess of target at the present time or to delay any action until the end of the financial year:

(a) The Fund's net income cannot be projected with a great deal of confidence. Net income is relatively small compared to the total of income and expenditures, and small variations in these aggregates are reflected in magnified deviation of actual from projected net income. Moreover, certain important factors affecting income--such as the interest rate on the SDR and the amount of purchases--are outside the control of the Fund, and the discharge of deferred income is unpredictable also. Delaying a decision until the end of the financial year would allow taking into account developments during the second half of the year and linking the disposition more closely to the amount of income actually realized.

(b) At the current juncture the degree of uncertainty might be considered somewhat smaller than in earlier reviews. The SDR interest rate has been comparatively stable recently; and continuation at the current level or a further decline would benefit net income, and the net income target could be achieved, *ceteris paribus*, with an increase of 55 basis points or less in that rate. In addition, any further settlement of charges deferred before May 1, 1986 will increase net income *pari passu*.

(c) An immediate reduction of the rate of charge would be consistent with, and bring the rate of charge on the use of ordinary resources more into line with, the recent trend in market interest rates. However, it would not meet the often expressed wish for a substantial degree of stability of Fund charges. Similarly, increasing the remuneration coefficient now would accelerate bringing the rate of return on Fund assets closer to market rates and to the return on other reserve assets.

(d) The net income target has been raised for FY 1987 and FY 1988 from 5 percent to 7.5 percent of reserves at the beginning of the financial year, and net income of SDR 26 million in excess of the target amount in FY 1986 has been added to reserves. Reserves and the Fund's financial position thus were strengthened modestly faster in FY 1986 than had been anticipated, and steps for further strengthening were taken.

(e) The level and duration of overdue obligations have further increased since the beginning of the financial year, and although there have been some positive developments, the situation continues to be serious and arrears are likely to rise over the next half year and further strengthening of the Fund's financial position may be needed. This would argue to wait until the end of the current year before redistributing the estimated surplus.

(f) Delaying a decision on the disposition of estimated income in excess of the target until the end of the year would permit taking account of the amount of deferred income and the consequent adjustments to the rate of charge and to remuneration payments, which might influence the choice between reducing charges and/or increasing remuneration, on the one hand, and a somewhat larger addition to the Fund's reserves, on the other.

(g) A delay until the end of the financial year would not preclude the Executive Board from then taking an action that it might consider taking now. It would still be possible to reduce the rate of charge or increase the rate of remuneration with effect from the beginning of the financial year or of the second half of the year if the actual outcome of the Fund's income and expenses exceeded the reserve target.

V. Summary and Conclusions

1. After the last annual review of the Fund's income position, the Executive Board adopted, for FY 1987 and FY 1988, a revised method of determining the two major elements affecting the Fund's income position—the rate of charge and the rate of remuneration--with the aim of sharing more equally among member countries the impact on Fund income of arrears in payments due to the Fund. Under that method, the rate of charge on the use of ordinary resources and the rate of remuneration are initially set without projections of deferred income. At the end of semiannual adjustment periods, the rates of charge and of remuneration are adjusted symmetrically and simultaneously so as to result in an amount of net income equal to the amount of charges it has become necessary to defer during the adjustment period. This mechanism removed one major element of uncertainty from achieving the target amount of net income.

2. During the first adjustment period under that revised method, i.e., the six months that ended October 31, 1986, actual net income of the Fund amounted to SDR 71 million, or SDR 26 million in excess of the target amount of SDR 45 million projected at the time of the annual review of the Fund's income position and of the determination of the rate of charge.

3. The comparatively much better outcome than projected at the beginning of the financial year reflected mainly two factors: (i) the discharge of overdue charges that had been deferred in FY 1986, and (ii) a decline below projected levels of the SDR rate of interest and consequently the rate of remuneration, which represents the major

operational cost element for the Fund. These two factors contributed SDR 20 million and SDR 12 million, respectively, to the excess of actual income over the projected amount.

4. Projections of net income for the year as a whole, taking into account developments since the annual review, indicate net income of SDR 128 million, or SDR 44 million above the net income target of 7.5 percent of reserves at the beginning of the financial year (i.e., SDR 84 million). As during the first half of the year, the amount in excess of target for the year as a whole reflects mainly two factors: (i) an SDR rate of interest below that projected at the beginning of the year and a rate of remuneration below the rate of charge which improves the Fund's income position, and (ii) the settlement of charges that had to be deferred before May 1, 1986. These two factors account for SDR 21 million and SDR 20 million, respectively, of net income in excess of the target projected for FY 1987.

5. The improved outlook for the Fund's financial position leads to the question whether Executive Directors would wish to take any action at the present time to bring projected net income for the financial year more closely into alignment with the target amount of income, or whether any such action should be delayed until net income for FY 1987 has actually been realized and determined. Such action could take the form of: (i) a reduction of the rate of charge for the remainder of FY 1987 (or also retroactively for the first half of the financial year); (ii) an increase in the remuneration coefficient for the period before February 1, 1987, i.e., for the third quarter of FY 1987 or also retroactively for the first half of the year; (iii) a combination of the two; or (iv) a decision to increase the addition to the Fund's reserves beyond the amount of the net income target for the financial year. Any decision in accordance with (i), (ii) or (iii) above would require a majority of 70 percent of the voting power of the Executive Board, since it would involve a change in the rate of charge or the rate of remuneration. Considerations relating to these options have been detailed in Section IV, subsections 2 and 3 above.

6. In the light of the foregoing considerations, there may be advantage in delaying a decision on the disposition of income in excess of the target amount until after the end of the financial year when the facts are known. It would still be possible to reduce the rate of charge or increase the rate of remuneration with effect from the beginning of the financial year or of the second half of the year if the actual outcome of the Fund's income and expenses exceeded the reserve target.

Decision on Principles of "Burden Sharing", the Fund's Income Target for FY 1987 and 1988, Rate of Charge, and Rate of Remuneration

Section I. Principles of "Burden Sharing"

1. The financial consequences for the Fund which stem from the existence of overdue financial obligations shall be shared between debtor and creditor member countries.

2. This sharing shall be applied in a simultaneous and symmetrical fashion.

Section II. Income Target for FY 1987 and 1988

1. During financial year 1987 and financial year 1988, the Fund's net income target shall be raised from 5 percent to 7.5 percent of the Fund's reserves at the beginning of each year. The additional net income shall be generated in accordance with the provisions of Section V. It shall be recorded separately in the financial statements of the Fund.

2. For financial year 1988, the Fund may decide to add supplemental income to be generated in accordance with the provisions of Section V. It shall be recorded separately in the financial statements of the Fund.

Section III. Rate of Charge

1. (a) The rate of charge referred to in Rule I-6(4) shall be determined at the beginning of financial year 1987 and financial year 1988. This determination shall be made on the basis of the estimated income and expense of the Fund during the year and the target amount of net and supplemental income for the year, and shall include the adjustment necessary to generate one-half of the additional net income and of the supplemental income for the year.

(b) During financial year 1987 and financial year 1988, when estimating income, no deduction shall be made for projected deferred income.

2. During financial year 1987 and financial year 1988, the rate of charge shall be further adjusted in accordance with the provisions of Section V.

3. The rate of charge in force as of the end of a financial year, as adjusted under Section V, shall continue to apply subsequently unless it is otherwise decided.

Section IV. Rate of Remuneration

1. Effective August 1, 1986, Rule I-10(d) shall cease to apply.

2. Effective February 1, 1987, Rule I-10 shall read as follows:

> I-10. (a) The rate of remuneration shall be equal to 100 percent of the rate of interest on holdings of SDRs under Rule T-1 (hereafter referred to as "SDR interest rate").
>
> (b) The relationship of the rate of remuneration to the SDR interest rate will be referred to as the "remuneration coefficient."

3. During financial year 1987 and financial year 1988, the rate of remuneration shall be adjusted in accordance with the provisions of Section V.

Section V. "Burden Sharing" in FY 1987 and 1988

1. In financial year 1987 and financial year 1988, and notwithstanding Rule I-6(4)(a) and (b) and Rule I-10, the rate of charge referred to in Rule I-6(4), and the rate of remuneration prescribed in Rule I-10 shall be adjusted in accordance with the provisions of this Section.

2. (a) In order to generate the additional net income referred to in Section II.1, and the supplemental income referred to in Section II.2, the rate of charge shall be adjusted in accordance with the provisions of Section III.1(a), and the rate of remuneration shall be adjusted, subject to the limitation in (c), in accordance with the provisions of this paragraph, so as to produce equal amounts of income.

(b) If income from charges becomes deferred during an adjustment period as defined in (d), the rate of charge and the rate of remuneration shall be further adjusted, subject to the limitation in (c), in accordance with the provisions of this paragraph, so as to generate, in equal amounts, an additional amount of income equal to the amount of deferred charges. For the purposes of this provision, special charges on overdue financial obligations under Decision No. 8165-(85/189)G/TR, December 30, 1985 shall not be taken into consideration.

(c) No reduction in the rate of remuneration under this paragraph shall be carried to the point where the average remuneration coefficient would be reduced below 85 percent for an adjustment period.

(d) Subject to the provisions of Section III.1(a), the adjustments under this paragraph shall be made as of May 1 and as of November 1 of each year:

shortly after October 31 for the period from May 1 to October 31; shortly after April 30 for the period from November 1 to April 30.

(e) Notwithstanding the provisions of (d), any adjustment made in respect of the first half of financial year 1987 shall affect the rate of remuneration only as of August 1, 1986.

(f) The operation of this decision shall be reviewed when the remuneration coefficient is reduced to 85 percent under (c).

3. A mid-year review of the Fund's income position shall be held shortly after October 31 of each year. If, after any adjustment under paragraph 2, the actual net income for the first six months of the financial year, on an annual basis, is below the target amount for the year by an amount equal to, or greater than, two percent of the Fund's reserves at the beginning of the financial year, the Executive Board will consider how to deal with the situation. If on December 15 no agreement has been reached as a result of this consideration, the rate of charge shall be increased as of November 1 to the level necessary to reach the target amount of net income for the year.

4. (a) An amount equal to the proceeds of any adjustment made under paragraph 2(a) in order to generate supplemental income in financial year 1988 shall be distributed, in accordance with the provisions of this paragraph, to members that have paid additional charges or have received reduced remuneration as a result of the adjustment, when there are no outstanding overdue charges and repurchases, or at such earlier time as the Fund may decide.

(b) An amount equal to the proceeds of any adjustment made under paragraph 2(b) in financial year 1987 or 1988 shall be distributed, in accordance with the provisions of this paragraph, to members that have paid additional charges or have received reduced remuneration as a result of the adjustment, when, and to the extent that, charges, the deferral of which had given rise to the same adjustment, are paid to the Fund. Distributions under this provision shall be made semi-annually.

(c) Distributions under (a) or (b) shall be made in proportion to the amounts that have been paid or have not been received by each member as a result of the respective adjustments.

(d) If a member that is entitled to a payment under this paragraph has any overdue obligation to the Fund in the General Department at the time of payment, the member's claim under this paragraph shall be set off against the Fund's claim in accordance with Decision No. 8271-(86/74), April 30, 1986 or any subsequent decision of the Fund.

Executive Board Decision No. 8348-(86/122) adopted July 25, 1986.

Rule I-6(4):

(4) The rate of charge on holdings acquired as a result of a purchase (i) in the credit tranches, or (ii) under the Extended Fund Facility (Executive Board Decision No. 4377-(74/114), as amended), or (iii) under the Facility for the Compensatory Financing of Export Fluctuations (Executive Board Decision No. 4912-(75/207), as amended), or (iv) under the Facility for the Problem of Stabilization of Prices of Primary Products (Executive Board Decision No. 2772-(69/47), as amended), or (v) under the Facility for Compensatory Financing of Fluctuations in the Cost of Cereal Imports (Executive Board Decision No. 6860-(81/81)), shall be determined in accordance with (a), (b), and (c) below.

(a) The rate of charge shall be determined at the beginning of each financial year on the basis of the estimated income and expense of the Fund during the year and the target amount of net income for the year. The latter shall be 5 percent of the Fund's reserves at the beginning of the year or such other percentage as the Executive Board may determine particularly in the light of the results in the previous financial year.

(b) A mid-year review of the Fund's income position shall be held shortly after October 31 of each year. If actual net income for the first six months of the financial year, on an annual basis, is below the target amount for the year by an amount equal to, or greater than, two percent of the Fund's reserves at the beginning of the financial year, the Executive Board will consider how to deal with the situation. If on December 15 no agreement has been reached as a result of this consideration, the rate determined under (a) at the beginning of the year shall be increased as of November 1 to the level necessary to reach the target amount of net income for the year.

(c) A review of the Fund's income position shall be held shortly after the end of each financial year. If the net income for the year just ended is in excess of the target amount for the year, the Executive Board will consider whether the whole or a part of the excess should be used to reduce the rate of charge, or increase the rate of remuneration to not more than the rate of interest of the SDR, retroactively for the year just ended, or both, or to place all or part of the excess to reserve.

(d) If the Fund's net income for a financial year is in excess of the target amount for that year, the Executive Board may for the purposes of the determinations and estimates referred to in (a) and (b) above in respect of the immediately subsequent financial year, decide to deem any part of the excess over the target amount that has been placed to reserve as income for that subsequent financial year.

Table 1. Assumptions Underlying the Projections
Financial Year 1987

(In millions of SDRs)

	Initial Projections		Actual	Revised
	First Half FY 1987	FY 1987	First Half FY 1987	Projections FY 1987
Ordinary Resources:				
1. Purchases				
Unremunerated reserve tranche	150	300	74	300
Credit tranches	1,372	2,416	548	2,867
Compensatory financing and Buffer Stock	800	1,600	285	1,445
Total	2,322	4,316	907	4,611
2. Repurchases	2,032	4,604	1,837	4,531
3. Average balances subject to charges	19,705	19,523	18,760	18,884
4. Average SDR holdings	2,250	1,879	2,657	2,243
5. Average remunerated positions	19,943	19,415	19,559	19,285
Borrowed Resources:				
1. SFF				
Repayments of borrowing	785	1,658	809	1,681
Repurchases	760	1,599	724	1,626
Average balances subject to charges	4,850	4,450	4,886	4,472
2. Enlarged Access				
Purchases	791	1,685	395	1,362
Repayments of borrowing	237	1,089	272	1,164
Repurchases	278	824	248	902
Average balances subject to charges	10,395	10,570	10,175	10,286
Interest Rates (percent):				
1. Average SDR interest rate	6.20	6.20	6.04	6.02
2. Average rate of remuneration				
Basic rate	6.04	6.04	5.89	5.91
Adjusted for burden sharing			5.44	
3. Average rate of charge				
Basic rate	6.00	6.00	6.00	6.00
Adjusted for burden sharing			6.39	
4. Average SFF interest rate	7.46	7.46	7.31	7.17
5. Average EAR net cost of borrowing	8.48	8.48	7.03	6.94

Table 2. Deferred Charges, Actual and Estimated, of Members Overdue in Payments to the Fund

(In millions of SDRs)

	Balance April 30 1986	Actual First Half FY 1987 1/	Payments of Amounts Deferred in Prior Years	Estimated Second Half FY 1987 1/	Total FY 1987 1/	Balance April 30 1987 1/
Overdue for six months or more:						
Gambia, The	1.5		-1.5		-1.5	
Guyana	7.8	2.5		2.3	4.8	12.5
Kampuchea, Democratic	7.9	0.4		0.4	0.8	8.6
Liberia	21.3	7.2		6.6	13.8	35.1
Peru		41.1		18.0	59.1	59.1
Sierra Leone	6.8		-6.8		-6.8	
Sudan	74.6	21.1	-9.8	19.1	30.4	105.0
Tanzania	2.2		-2.2		-2.2	
Viet Nam	5.0	0.9		0.9	1.8	6.8
Subtotal	127.0	73.1	-20.3	47.3	100.2	227.2
Overdue 30 days - six months:						
Jamaica				39.6	39.6	39.6
Romania				20.1	20.1	20.1
Zambia				44.0	44.0	44.0
Subtotal				103.8	103.8	103.8
Overdue less than 30 days				58.5	58.5	58.5
Total - All members overdue	127.0	73.1	-20.3	209.6	262.4	389.5

1/ Does not include special charges for FY 1987.

Table 3. Effects on Net Income for 1987
of Differences between Initial and Revised Estimates

(In millions of SDRs)

	Initial Estimates	Revised Estimates	Difference	Explanation of Differences between Initial and Revised Estimates: Lower than Estimated Average Use of Resources	Lower than Estimated Average SDR Interest rate and Rate of Remuneration	Other
1. Operational income						
a. Periodic charges	1,171	1,170	-1	-38	--	37 1/
b. Interest on SDR holdings	116	135	19	23	-4	--
c. Charges from borrowed resources net of interest expense	132	133	1	--	--	1
d. Service charges	28	29	1	--	--	1
e. Special charges	--	5	5	--	--	5
	1,447	1,472	25	--	--	44
f. Deduct: charges deferred	--	57	57	--	--	57
Total	1,447	1,411	-32	-15	-4	-13
2. Operational expense						
Remuneration	1,159	1,089	-70	-15	-25	-30 2/
3. Net operational income	288	326	38	--	21	17
4. Administrative expense	204	198	-6	--	--	-6
5. Net income (deficit)	84	128	44	--	21	23

1/ Represents addition to periodic charges to finance one half of the net amount of charges deferred in the first half of FY 1987.

2/ Includes SDR 37 million reduction of remuneration to finance one half of the net amount of charges deferred in the first half of FY 1987.

Table 4. Effect of Different Assumptions on the Fund's Income Position Financial Year 1987

(In millions of SDRs)

	Average Annual SDR Rate of Interest for Second Half of FY 1987 (In percent)								
	5.60	5.70	5.80	5.90	6.00	6.10	6.20	6.30	6.40
Changes in projected purchases:									
1. As projected in Appendix Table 1 Net income 1/	160	152	144	136	128	120	112	104	96
2. Unremunerated reserve tranche purchases higher or lower by 20 percent (SDR 45 million) Change in net income	∓0.6	∓0.6	∓0.6	∓0.7	∓0.7	∓0.7	∓0.7	∓0.7	∓0.7
3. Credit tranche and compensatory financing purchases higher or lower by 20 percent (SDR 695 million) Change in net income	±4.3	±4.1	±3.9	±3.8	±3.6	±3.4	±3.3	±3.1	±2.9
4. Purchases financed from borrowed resources higher or lower by 20 percent (SDR 195 million) Change in net income	±1.1	±1.1	±1.1	±1.1	±1.1	±1.1	±1.1	±1.1	±1.1

1/ Net income for the year at the present rate of charge of 6.0 percent.

Table 5. Factors Explaining the Difference Between the Basic Rate of Remuneration and the Basic Rate of Charge FY 1987

	Initial Projections	Revised Projections
1. Rate of remuneration	6.04	5.91
2. Rate of charge	6.00	6.00
3. Difference	0.04	-0.09
Explained by:		
a. Interest-free resources	1.03	1.03
b. SDR holdings	0.02	0.01
c. Service charges	0.14	0.15
d. Special charges	--	0.01
e. Margins on SFF and EAR 1/	0.25	0.26
f. Administrative expenses	-1.04	-1.05
g. Net income	-0.36	-0.50
	0.04	-0.09

1/ Income from margins, net of remuneration expense resulting from substitution of ordinary for borrowed resources.

Table 6. Grant Element in Average Rates of Income and Expense FY 1982-1987

(In Percent)

	Financial Year					First Half
	1982	1983	1984	1985	1986	1987
1. SDR interest rate	13.05	10.20	8.70	8.81	7.44	6.04
2. Combined domestic five-year interest rate	13.32	10.98	10.48	10.64	8.46	6.80
3. IBRD lending rate	11.08	11.31	10.42	9.72	8.79	8.32
4. Rate of remuneration	11.05	8.42	7.39	7.77	6.85	5.89
5. Effective rate of remuneration 1/	6.29	5.60	5.52	6.09	5.36	4.51
6. Rate of charge	6.25	6.60	6.60	7.00	7.00	6.00
7. Grant element: 2/						
a. Compared with SDR interest rate						
Rate of remuneration	6.28	5.91	4.49	3.55	2.07	0.54
Effective rate of remuneration	21.22	15.28	10.89	9.30	7.31	5.54
Rate of charge	21.35	11.97	7.19	6.19	1.55	0.14
b. Compared with combined domestic five-year interest rate						
Rate of remuneration	7.09	8.37	10.21	9.45	5.54	3.24
Effective rate of remuneration	21.95	17.60	16.39	14.98	10.67	8.16
Rate of charge	22.08	14.33	12.82	11.99	5.03	2.85
c. Compared with IBRD lending rate						
Rate of remuneration	0.10	9.39	10.02	6.54	6.63	8.39
Effective rate of remuneration	15.63	18.55	16.21	12.18	11.73	13.15
Rate of charge	15.77	15.30	12.63	9.12	6.12	8.01

1/ The total of remuneration paid to creditors expressed as a percentage of total creditor positions (remunerated and unremunerated).

2/ The grant element is calculated as the face value of a commitment less the discounted present value of the future flow of payments of principal and interest expressed as a percentage of the face value.