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To: Members of the Executive Board

From: The Acting Secretary

Subject: Draft Report to the Interim Committee on the Eighth General Review of Quotas

The attached draft report of the Executive Board to the Interim Committee on the Eighth General Review of Quotas has been scheduled for discussion at 3:00 p.m., on Tuesday, January 4, 1983.

Att: (1)

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INTERNATIONAL MONETARY FUND

Report of the Executive Board to the Interim Committee of the Board of Governors on the International Monetary System on the Eighth General Review of Quotas

December 29, 1982

I. Introduction

1. The communique of the Interim Committee, issued after its 19th meeting held in Toronto, Canada in September 1982, stated that:

> "There was widespread support in the Committee on the urgent need for a substantial increase in quotas under the Eighth General Review. The Committee reiterated its view that quotas must remain the primary source of financial resources for the Fund's operations and that, therefore, the Review should result in an increase in quotas that would be large enough to enable the Fund to perform its functions in an effective manner in the 1980s. The Committee also reiterated its view that the occasion of an enlargement of the Fund under the Eighth General Review should be used to bring the quotas of members more in line with their relative positions in the world economy, taking account of the case for maintaining a proper balance between the different groups of countries. The Committee also asked the Executive Board to assess the adequacy of existing arrangements to deal with major strains in the international financial system.
>
> The Committee urged the Executive Board to pursue its work on the issues of the Review as a matter of high priority, so that the remaining issues on the size and distribution of the quota increase could be resolved by the time of the Committee's next meeting in April 1983."

2. Since the last meeting of the Interim Committee, the Executive Board has considered (i) the size of the overall increase in quotas; (ii) the distribution of the overall increase, including the position of countries with very small quotas in the Fund, and (iii) the mode of payment for the increase in quotas. This Report presents views expressed in the Executive Board on each of these three aspects of the Review, with the aim of focusing the discussion by the members

of the Interim Committee and to facilitate ... ement on the Eighth General Review. Section V provides a s... summary of the main issues dealt with in this Report.

II. Size of the Overall Increase

3. Most Directors are of the view that members' needs for balance of payments financing, especially of a conditional nature, will be large through much of the 1980s. In order to enable the Fund to deal effectively with the problems of adjustment that are within its competence, and that are likely to be encountered in the 1980s, these Directors support a correspondingly large increase in quotas under the Eighth General Review. A number of these Directors have indicated that a doubling in the size of the Fund to the order of SDR 125 billion is needed. Many Directors consider that an overall increase ranging from SDR 90 billion to SDR 100 billion (i.e., an increase ranging from approximately 50 per cent to 64 per cent of present quotas of SDR 61.1 billion) would be acceptable. A few Directors believe that the size of the payments imbalances of recent years can be expected to diminish, and that their distribution might, later in the decade, move toward countries less likely to use Fund resources, implying a lesser need for balance of payments financing from the Fund. These Directors believe that a somewhat smaller increase in quotas, say, to an overall size of the order of SDR 85 billion, would suffice.

4. The proposal to extend and enlarge the Fund's existing standing borrowing arrangements (GAB) is generally favored by Executive Directors.

However, they continue to stress the importance for the Fund to rely on members' subscriptions as the primary source for the financing of its operations and transactions. In this connection, a number of Directors believe that unless the overall increase in quotas would be relatively large, it would be difficult for the Fund to maintain its financial role in the international monetary system without continued recourse to borrowing after the new quotas come into effect.

Those Directors who feel that the payments imbalances will tend to diminish later in the decade, believe not only that the Fund's need to borrow will be reduced, but that the Fund is likely to borrow mainly to meet exceptional increases in demand on its resources; the proposed enlarged borrowing arrangements would help provide for any such contingencies during the 1980s.

III. Distribution of Overall Increase

5. The Executive Board has had extensive discussions on the distribution of an overall increase in quotas, and broadly agrees that the increases of quotas under the Eighth General Review should lead to a distribution of quotas that better reflects the relative economic positions of members. The quota calculations, based on the revised quota formulas that were agreed by the Executive Board in August 1982, are generally regarded as reasonable indicators of the relative economic positions of countries in the world economy. Furthermore, most Directors agree that an increase in quotas should be distributed using a method that would apply uniformly to all members. There was also general

agreement that each member should receive a meaningful increase in its quota under the Eighth General Review.

6. As regards the extent to which present quotas should be adjusted in order to reflect better the relative economic positions of members, the Executive Board has found it useful to refer to a broad statistical measure of adjustment. This measure is referred to below as the adjustment coefficient, and it indicates for each member the percentage reduction in the difference between its share in present quotas and its share in calculated quotas. Many Directors are of the view that the distribution of quotas, and the appropriate size of the adjustment coefficient, would be easier to decide if the size of the overall increase in quotas were larger rather than smaller.

7. As regards the methods that could be used to distribute an increase in quotas, most Directors felt that the distribution of a part of a given total increase based on each member's share in the total of calculated quotas would be acceptable. Under this method, such changes in quotas directly reflect members' relative economic positions, as indicated by the calculated quotas. Furthermore, the percentage rate at which each member's share in present quotas moves towards its corresponding share in calculated quotas would be the same, i.e., the adjustment coefficient is the same for all members, which most Directors found to be a desirable feature of this method of distributing quota increases.

Other methods of distributing increases in quotas were also considered. Some of these methods provide for a progressively larger increase in quotas the greater the difference between a member's share in present quotas and its share in calculated quotas. Consideration was also given to methods that based increases in quotas on the positive (absolute) differences between members' calculated quotas and present quotas. Some of these other methods of distribution produced relatively large changes in many members' shares in quotas, but they all raised objections because the adjustment coefficient is not the same for all members.

8. The Executive Board also considered the means of assuring a meaningful increase in quotas for each member. A large number of Executive Directors believe that, in addition to any allocation in proportion to members' shares in calculated quotas, each member's present quota should be increased by the same percentage, i.e., by providing for an equiproportional increase in quotas. These Directors are of the view that an equiproportional increase in quotas, which has been an important part of all previous increases in quotas, is simple in concept and straightforward in its application; when combined with increases in quotas based on members' shares in calculated quotas, all members move towards their shares in calculated quotas at the same, though slower, rate. A few Directors believe that instead of an equiproportional increase in quotas, members should receive a minimum increase in quotas which would apply only to those members whose shares in calculated quotas would not yield an increase equal to or greater than the minimum increase. Most Directors did not accept this method, partly because it is complicated to apply and also because the adjustment coefficient is different from member to member.

9. The relationships between various overall increases in quotas, and their distribution based on (i) amounts to be allocated in the form of

an equiproportional increase in quotas and (ii) the remainder to be allocated in proportion to members' shares in calculated quotas, are shown in the Tables appended to this Report. Each Table shows, for different sizes of the Fund, varying sizes of the equiproportional increase and the corresponding sizes of the adjustment coefficient. The changes in the shares in the Fund of groups of countries, following the country classification presented in IFS, are also shown. For ease of reference, the quota calculations for individual members that are summarized in the Appendix are shown in a separate document which is being circulated concurrently.

10. As regards the size of the adjustment coefficient, the views of the Executive Directors have ranged from relatively low to relatively high coefficients, with the views of a number of Executive Directors tending to range around the mid point of the coefficients shown in the Appendix Tables.

A few Directors, stressing the need to avoid unduly abrupt changes in the quota shares of members and to ensure that each member receives a meaningful increase in its quota, favor an adjustment coefficient of the order of 8 per cent in a Fund size of SDR 90 billion (and corresponding coefficients of 9.7 per cent in a Fund size of SDR 100 billion and 12.8 per cent in a Fund size of SDR 125 billion). This implies that 75 per cent of the overall increase in quotas would be distributed in the form of an equiproportional increase. A few Executive Directors have indicated that in view of the relatively large differences for most members between their shares in present and calculated quotas, and taking into account the Fund's need to maximize the additions to its holdings of usable assets, it would be appropriate to achieve the maximum rate of adjustment to members' shares in calculated quotas on this occasion. This would imply that there would not be an equiproportional increase in quotas. An overall increase in the Fund to SDR 90 billion would yield a maximum adjustment coefficient of 32.2 per cent--i.e., the difference between each member's share in present quotas and its share in calculated quotas would be reduced by almost one-third. For a Fund size of SDR 100 billion, the maximum adjustment coefficient rises to 39 per cent, while for a Fund size of SDR 125 billion, the maximum adjustment coefficient comes to 51.2 per cent, (See Col. (7) of Appendix Table 2, and 3).

A few other Directors have expressed the view that the adjustment coefficient could reasonably be of the order of at least half the maximum rate of adjustment--i.e., an adjustment coefficient of at least 16 per cent in a Fund size of SDR 90 billion and 19.5 per cent and 25.6 per cent in a Fund size of SDR 100 billion and SDR 125 billion, respectively, (Col. 3 of Appendix Tables 1, 2, and 3). A number of Directors believe that a rather faster rate of adjustment would be desirable in present circumstances. These Directors suggest adjustment coefficients ranging between 20-25 per cent for a Fund size of SDR 90 billion, and most of these Directors stress that coefficients in the upper half of this range would produce acceptable results in terms of distribution of quotas.

11. The share of the non-oil developing countries, taken as a group, falls from its present level in each of the calculations shown in the

Appendix Tables. Several Directors are of the view that for political and economic reasons the share of the non-oil developing countries should not fall in the Fund. A few other Directors hold the view that in coming to an agreement on the size of the adjustment coefficient, account should be taken of the present position in the Fund of the group of non-oil developing countries, and, as noted in the last communique of the Interim Committee, that account should be taken of "the case for maintaining a proper balance between the different groups of countries." Many Directors, however, continue to feel that quota increases should be based on members' individual positions and not on the positions of groups of members; these Directors believe it is inappropriate to impose arbitrary constraints on changes in the shares of certain groups of members in quotas and votes.

12. The Executive Board has also discussed the position in the Fund of the very small quota countries--i.e., those with quotas that at present are less than SDR 10 million. A number of Directors feel that on economic grounds the share in the Fund of this group of countries should be raised slightly, after taking account of the increase in quotas that might be agreed under the Eighth General Review. The additional increase in quotas, above the overall increase in the size of the Fund that would be agreed, would be very small. Other Directors feel that it is important to maintain uniformity of treatment of members in distributing increases in quotas. They also feel that a special adjustment in the very small quotas could result in these members satisfying their needs for Fund resources because they could also use the less conditional facilities, which do not involve upper

tranche conditionality as regards their use of the Fund's resources. A few Directors feel that it might be appropriate to examine the matter further in the light of the increases in quotas that might be agreed under this Review, and particularly in the context of any rounding procedures that might be adopted as regards those increases.

IV. Payment for Increases in Quotas

13. The Executive Board has discussed the mode of payment for the increases in quotas. The Articles of Agreement provide that each member which consents to an increase in quota shall "pay to the Fund twenty-five per cent of the increase in special drawing rights, but the Board of Governors may prescribe that this payment may be made, on the same basis for all members, in whole or in part in the currencies of other members specified, with their concurrence, by the Fund, or in the member's own currency... The balance of the increase shall be paid by the member in its own currency."

14. Most Directors believe that twenty-five per cent of the increase in quotas should be paid in reserve assets. Most of these Directors would prefer that the reserve asset payment be in the form of SDRs. A reserve asset payment made in SDRs provides the greatest enhancement of the liquidity position of the Fund, improves the Fund's income position when the rate of remuneration is lower than the SDR rate, as at present, and it also promotes the use of the SDR in Fund operations and transactions. However, approximately one-fifth of the total SDRs allocated are presently held by the General Department of the Fund and over 60 per cent are held by the industrial countries. Furthermore, approximately

90 members do not have at present sufficient SDRs to pay to the Fund 25 per cent of an increase in quotas of the order presently discussed. In these circumstances, a relatively large number of members would need to buy SDRs, perhaps mainly from the Fund itself, to pay them to the Fund. Consequently, many Directors believe it may be appropriate to give members an option to pay 25 per cent of the increase in quotas in SDRs or in the currency of another member prescribed by the Fund, with the concurrence of the issuer. These Directors recall that in all previous increases in quotas, except one, 25 per cent of the increase was paid in reserve assets, and the liquidity position of the Fund was, thereby, strengthened to the maximum extent. The granting of the option requires a decision of the Board of Governors taken by a 70 per cent majority of the total voting power.

Directors who support the payment of a reserve asset, point out that such a payment will under existing decisions either create a reserve tranche position for a member, or enlarge the paying member's existing reserve tranche, by an amount equal to the reserve asset payment. Thus, reserve asset payment to the Fund results only in a change in the composition of a member's reserves, and does not represent a net drain on a member's reserves. They also emphasize that a member can draw on its reserve tranche without challenge to its representation of balance of payments need.

15. A number of other Directors believe members should not be required to pay 25 per cent of the increase in quotas in reserve assets. They point out that some members do not hold sufficient official foreign assets (SDRs and foreign exchange) to make a reserve asset payment to

the Fund in connection with the increases in quotas of the size that are presently under consideration. In these circumstances, and also considering their views on the need to supplement reserves, these Directors believe that a decision to alloca e SDRs in the fourth basic period would be the most suitable way to enable members to make a payment of 25 per cent of the quota increase in SDRs. They consider that in the absence of a decision to allocate SDRs, members should be given the option to pay the increase in quotas wholly in their own currency.

V. Summary of Main Issues

16. The main outstanding issues discussed above with regard to the Eighth General Review may be summarized as follows:

1. As regards the size of the overall increase in quotas, most Executive Directors hold the view that an increase in the size of the Fund to between SDR 90 billion and SDR 100 billion would be acceptable, although many prefer a Fund of SDR 125 billion.

2. On the distribution of the increases in quotas, most Directors agree that quotas should be distributed in accordance with members' shares in calculated quotas, after providing for an equiproportional increase that would help ensure a meaningful increase in quotas for all members. In determining the extent of the adjustment in members' shares in quotas, most Directors believe that the adjustment coefficient should fall within a range of the order of 16 to 25 per cent for a Fund size of SDR 90 billion, and the adjustment coefficient would be correspondingly larger for larger overall increases in quotas.

3. As regards the mode of payment for the increase in quotas, most Directors believe that 25 per cent of the increase should be paid in reserve assets, and members should be given the option to pay in SDRs or in currency specified by the Fund, with the concurrence of the issuer. Other Directors take the view that there is a need to supplement reserves; in the absence of an allocation of SDRs, they believe members should also be given the option to pay increases in quotas wholly in their own currency.

Table 1. Alternative Illustrative Distributions of the Overall Increase in Quotas (Fund of SDR 90 Billion)

(In per cent)

	Present quota shares (1)	Apportionment of overall increase into equiproportional/selective increases					
		75/25 (2)	50/50 (3)	38/62 (4)	30/70 (5)	22/78 (6)	0/100 (7)
1. Equiproportional increase, per cent of present quota 1/		35.7	23.7	18.0	14.3	10.6	--
2. *Adjustment coefficient* 2/	--	*8.0*	*16.1*	*20.0*	*22.5*	*25.0*	[illegible]
3 Distribution of shares (per cent of total)							
Industrial countries	61.3	61.7	62.2	62.4	62.5	62.6	63.0
Non-industrial countries	38.7	38.3	37.8	37.6	37.5	37.4	37.0
Of which.							
Major oil-exporting countries	10.9	11.2	11.4	11.6	11.7	11.7	12.0
Non-oil developing countries	27.8	27.1	26.4	26.1	25.9	25.6	25.0

1/ The equiproportional increase plus the increase allocated to the member with the lowest ratio of calculated to present quota (Lao, P.D.R.) provide the smallest increase, in per cent of present quota, of 36.7, 25.8, 20.8, 17.5, 14.2, and 4.6 per cent, respectively, in Cols. 2 through 7 in the table.

2/ This figure represents the percentage reduction for each member of the difference between its share in the total of present quotas and its share in calculated quotas.

Table 2. Alternative Illustrative Distributions of the Overall Increase in Quotas (Fund of SDR 100 Billion)

(In per cent)

	Present quota shares	Apportionment of overall increase into equiproportional/selective increases					
		75/25	50/50	36/64	30/70	23/77	0/100
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
1. Equiproportional increase, per cent of present quota 1/		47.9	31.9	22.9	19.3	14.7	--
2. *Adjustment coefficient 2/*	--	*9.7*	*19.5*	*25.0*	*27.2*	*30.0*	*39.0*
3. Distribution of shares (per cent of total)							
Industrial countries	61.3	61.8	62.3	62.6	62.7	62.9	63.4
Non-industrial countries	38.7	38.2	37.7	37.4	37.3	37.1	36.6
Of which:							
Major oil-exporting countries	10.9	11.2	11.6	11.7	11.8	11.9	12.2
Non-oil developing countries	27.8	27.0	26.1	25.6	25.4	25.2	24.4

1/ The equiproportional increase plus the increase allocated to the member with the lowest ratio of calculated to present quota (Lao, P.D.R.) provide the smallest increase, in per cent of present quota, of 49.6, 35.0, 26.7, 23.8, 19.6, and 6.3 per cent, respectively, in Cols. 2 through 7 in the table.

2/ This figure represents the percentage reduction for each member of the difference between its share in the total of present quotas and its share in calculated quotas.

Table 3. Alternative Illustrative Distributions of the Overall Increase in Quotas (Fund of SDR 125 Billion)

(In per cent)

	Present quota shares (1)	Apportionment of overall increase into equiproportional/selective increases 75/25 (2)	50/50 (3)	40/60 (4)	30/70 (5)	22/78 (6)	0/100 (7)
1. Equiproportional increase, per cent of present quota 1/		78.6	52.4	41.9	31.4	22.9	--
2. *Adjustment coefficient 2/*	--	*12.8*	*25.6*	*30.7*	*35.8*	*40.0*	*51.2*
3. Distribution of shares (per cent of total)							
Industrial countries	61.3	62.0	62.7	62.9	63.2	63.4	64.0
Non-industrial countries	38.7	38.0	37.3	37.1	36.8	36.6	36.0
Of which:							
Major oil-exporting countries	10.9	11.3	11.8	11.9	12.1	12.2	12.6
Non-oil developing countries	27.8	26.7	25.6	25.2	24.7	24.4	23.4

1/ The equiproportional increase plus the increase allocated to the member with the lowest ratio of calculated to present quota (Lao, P.D.R.) provide the smallest increase, in per cent of present quota, of 81.3, 57.5, 48.0, 38.6, 30.9, and 10.0 per cent, respectively, in Cols. 2 through 7 in the table.

2/ This figure represents the percentage reduction for each member of the difference between its share in the total of present quotas and its share in calculated quotas.