**FOR AGENDA**

SM/03/306

August 29, 2003

To: Members of the Executive Board

From: The Secretary

Subject: **Report of the Executive Board to the International Monetary and Financial Committee on Quotas, Voice and Representation**

Attached for consideration by the Executive Directors is the report of the Executive Board to the International Monetary and Financial Committee on quotas, voice and representation, which is tentatively scheduled for discussion on **Friday, September 5, 2003**.

It is expected that the report, after any further changes in light of the Executive Board discussion, will be posted on the Fund's external website following its circulation to the members of the IMFC.

Questions may be referred to Ms. Metzgen, FIN (ext. 37863) and Mr. Friedman, SEC (ext. 36858).

This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities.

Att: (1)

Other Distribution:
Department Heads

INTERNATIONAL MONETARY FUND

# Report of the Executive Board to the IMFC on Quotas, Voice and Representation

Prepared by the Finance and Secretary's Departments

Approved by Eduard Brau and Shailendra J. Anjaria

August 29, 2003

1. The resolution concluding the Twelfth General Review of Quotas in January 2003 indicated that the Executive Board intended, during the period of the Thirteenth General Review, "to monitor closely and assess the adequacy of Fund resources, to consider measures to achieve a distribution of quotas that reflects developments in the world economy, and to consider measures to strengthen the governance of the Fund." This status report provides an update on developments in these areas also in response to a request from the International Monetary and Financial Committee.[1] It indicates that Fund liquidity is satisfactory at present; and that quota-related issues will continue to be considered by the Executive Board, also in the context of its regular assessments of the adequacy of Fund resources. The Executive Board is pursuing voice and representation issues on two different tracks—quota-related topics and administrative and capacity-building initiatives.

2. The Executive Board recognizes the importance of the Fund having adequate resources to fulfill its critical responsibilities and accordingly conducts semi-annual reviews of Fund liquidity. At the time of the last review, the Fund's one-year forward commitment capacity (FCC) amounted to SDR 63 billion as of end-July 2003.[2] The Executive Board concluded that the Fund's liquidity position was adequate and that the Fund would likely be able to meet the near-term projected needs of its members, even under somewhat unfavorable circumstances. This assessment was based on the assumption of a pick up in global economic activity in the second half of 2003 and an expectation that the near-term demand for Fund resources would be relatively small. Further, should the need arise, the New Arrangements to Borrow/General Arrangements to Borrow (SDR 34 billion) also remain available. However, given the importance of the Fund having adequate resources to fulfill its responsibilities and

[1] See *Communiqué of the International Monetary and Financial Committee of the Board of Governors of the International Monetary Fund*, Press Release No. 03/50, 4/12/03, para. 19.

[2] See *The Fund's Liquidity Position—Review and Outlook*, EBS/03/xx, 9/xx/03.

that difficulties in the world economy are hard to predict, continued close monitoring of the Fund's liquidity position will be important.

3. In a discussion on July 31, 2003, the Executive Board considered quota distribution issues including measures to achieve a distribution of quotas that reflects developments in the world economy.[3] In the meeting, Directors took stock of areas of emerging consensus for new quota formulas and considered certain issues involved in revising and updating the quota formulas. The preliminary results of calculations, using variables that could be included in a new quota formula, were available to the Board. Directors also exchanged views on possible approaches to accomplish broad changes in quotas and voting power, based on lessons from past quota reviews.

4. In considering how best to achieve changes in quota shares that reflect developments in the world economy, Directors observed that significant adjustments in quota shares have tended to take place in the context of general quota increases. Most Directors, therefore, saw considerable merit in a package of measures that would involve—in the context of the next general quota increase:

- a general quota increase with a relatively large selective element allocated by means of a new quota formula;
- ad hoc quota increases aimed at addressing the clearest cases of out-of-lineness; and
- an increase in basic votes specifically aimed at correcting the erosion of the voting power of the smallest members.

In the view of these Directors, such a package may represent the best opportunity to assemble the broad consensus needed for adoption. It was noted, however, that an increase in basic votes would require an amendment of the Articles of Agreement.

5. While most Directors recognized that, in view of the Fund's satisfactory liquidity position, there is no need for a quota increase at present, many Directors underscored the need for continued strong efforts to build a consensus among the membership on the elements of such a package. Many Directors also encouraged continued exploration of the scope for more limited ways of changing quotas, in particular by ad-hoc quota adjustments that would address cases of serious out-of-lineness. Most Directors indicated their willingness to consider an increase in basic votes outside the context of a general quota increase, although it was acknowledged that the required majority does not exist at this stage. Directors called for future work on quota-related topics to include updating the data used to

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[3] The *Acting Chair's Summing Up Quota Distribution—Selected Issues,* BUFF/03/155, 8/22/03 (attached) provides a comprehensive summary of the discussion.

calculate variables and alternative quota formulas, further work on measuring capital flows and financial openness, and the availability of capital account data.

6. Strengthening Fund governance requires a deliberate and sustained effort by the membership as a whole to enhance collaboration and consensus in the formulation and implementation of policies by its governing bodies. While administrative and technical capacities may not be the only, or main, determinants of the voice and representation of developing countries in the decision-making process, such factors can be unnecessarily constraining. Executive Directors have, therefore, continued their examination of measures designed to enhance the capacity of Executive Directors from developing and transition countries to participate effectively in decision making in the Fund and thereby better serve member countries.[4] The first step in this area was taken last April, when the Executive Board agreed that Executive Directors with 20 or more member countries—including the Executive Directors from sub-Saharan Africa—may add three persons to the staff in their offices who contribute to the Executive Directors' analysis of Fund policy and operational issues in preparation for discussions in the Executive Board and with Fund management and staff.

7. Since then, the Executive Directors have advanced their work on proposals in several other areas aimed at enhancing capacity in Executive Directors' offices—in particular, those of developing and transition countries. First, efforts to attract high-quality persons in the offices of Executive Directors will be furthered by the agreement to make available informal voluntary guidelines on the qualifications and duties of persons in those positions. Second, the Executive Directors have agreed that further training for new members of Executive Directors' staff could be provided on a regular basis. In that connection, the IMF Institute is developing a new course focusing on financial programming issues. Third, Executive Directors have examined ways in which new technology could facilitate their close and effective communication with their authorities in capitals. To that end, Executive Directors have asked the staff to increase the number of document series that are available on the Executive Directors' Extranet, a secure vehicle for making electronic versions of Board documents available quickly to authorities in capitals. Executive Directors have also agreed to explore recently available video teleconferencing technology as an additional useful tool for facilitating close contact with their authorities in member countries.

[4] See *Capacity-Building Measures for the Offices of Executive Directors* (EBAM/03/111, 8/20/03) and Correction 1 (EBAM/03/111, 8/22/03).

BUFF/03/155
August 22, 2003

**The Acting Chair's Summing Up**
**Quota Distribution—Selected Issues**
**Executive Board Meeting 03/76**
**July 31, 2003**

Executive Directors welcomed the opportunity to discuss further a number of issues related to the distribution of quotas of Fund members. Building on progress achieved during earlier discussions, the views expressed by the Board today will provide the basis for a status report to the IMFC, in accordance with the resolution of the Board of Governors of January 2003, which concluded the Twelfth General Review of Quotas without an increase in quotas. The resolution noted the Executive Board's intention to monitor closely and assess the adequacy of its resources, to consider measures to achieve a distribution of quotas that reflects developments in the world economy, and to consider measures to strengthen the governance of the Fund.

As part of this work program, Directors discussed how the broad consensus for arriving at new quota formulas might develop going forward, and considered certain issues involved in revising and updating the quota formulas to reflect changes in the world economy and measure more adequately countries' relative positions. They also had a useful exchange of views on possible approaches to accomplish broad changes in quotas and voting power.

Today's discussion confirmed the broad support that has emerged for a formula that is simpler and more transparent than the traditional formulas. The formula would be based on an updating of the traditional economic and financial variables, and comprise at most four variables, including GDP as the most important indicator of countries' economic size, along with measures of openness, variability of current receipts and net capital flows, and reserves. Our discussion also reiterated the various concerns that have been expressed in previous discussions on the inclusion of some of these variables and on different aspects of the quota formulas. Those views and concerns have been reflected in concluding remarks or summings up of the previous discussions.

Directors reviewed the issue of the high correlation among the economic and financial variables in the existing quota formulas as well as among the updated variables. Most Directors saw this correlation as unavoidable, noting that approaches to reducing or eliminating the correlation would entail significant drawbacks, including reduced transparency of the formula. A few Directors nevertheless saw merit in further work to try to reduce the correlation among the variables. Because the variables are correlated, Directors acknowledged that the coefficient attached to each variable cannot be taken to represent each variable's relative economic importance. Directors recalled, in this context, the conclusion of previous discussions that the precise choice of weights will ultimately require the Executive Board to exercise judgment regarding an outcome that could command wide support.

Directors had a further discussion on options to modernize the quota formulas by including measures of capital flows. Many Directors continued to support including a measure of the variability of net capital flows and current receipts, to reflect countries' balance of payments vulnerability in the quota formulas. Directors also discussed possible approaches to introducing an outcome-based indicator of financial openness in the quota formula. A few Directors expressed interest in using a measure of capital flows, and a number of other Directors encouraged further efforts towards the inclusion of a stock variable capturing the asset and liability positions of a member. It was widely recognized, however, that, at present, such a variable cannot yet be operationalized due to lack of data for many members.

Directors noted that preliminary results of calculated quotas, using variables broadly endorsed for including in a new quota formula, would not lead to a significant change in calculated quota shares across country groups. However, they underscored that a new quota formula would make a significant difference in measuring the out-of-lineness of the quotas of individual countries. Many Directors also observed that, for a number of countries, actual quota shares are considerably lower than calculated quota shares, almost regardless of specific formulas, whereas the opposite appears to be true for many other countries. A number of Directors considered that these outcomes underscore the need for a political decision by the membership to secure quota shares that would strengthen the representation of developing countries in the Fund. A number of other Directors cautioned that changes in quota distribution should not target an a priori distribution between groups of countries. A few Directors expressed interest in the suggestion that a subgroup of members could voluntarily accept to transfer quota shares to other members. A few other Directors called for a better representation of transition countries in the Fund.

In discussing how best to move forward toward achieving adjustments in quota shares, Directors recognized the potential benefits that a package of changes in quotas, based on a new quota formula, could confer. They observed that significant adjustments in quota shares have tended to take place in the context of general quota increases, given the opportunity that general quota increases have provided to include elements that benefit the membership as a whole. Most Directors therefore saw considerable merit in a package that would involve—in the context of the next general quota increase—the following elements: a general increase with a relatively large selective element allocated by means of a new quota formula; ad hoc quota increases aimed at addressing the clearest cases of out-of-lineness; and an increase in basic votes specifically aimed at correcting the erosion of the voting power of the smallest members. It was noted, however, that an increase in basic votes would require an amendment of the Articles of Agreement.

Most Directors recognized that, in view of the Fund's satisfactory liquidity position, there is no need for a quota increase at present. Noting that changes in the world economy are hard to predict, many Directors nevertheless underscored the need for continued strong efforts to build a consensus among the membership on the elements of a package, including on a new, improved quota formula. Many Directors also encouraged continued exploration of the scope for more limited ways of changing quotas, in particular by ad-hoc quota adjustments that would address cases of serious out-of-lineness. Most Directors indicated their willingness to consider an increase in basic votes outside the context of a general quota increase, as a direct means of responding to calls for enhancing the voice of developing countries, in particular of the smallest members, although it was acknowledged that, at this stage, the required majority does not exist.

Directors supported the proposal that future work by the staff on quota related topics include updating the data used to calculate variables and alternative quota formulas. Many Directors also saw a need for further work on measuring capital flows and financial openness and more generally the availability of capital account data that could be used to capture these concepts.

Directors recognized the importance of the Fund having adequate resources to fulfill its critical responsibilities. In this regard, the most recent review of the Fund's liquidity position in April 2003 concluded that the Fund's current and prospective position is adequate. They urged the staff to continue to monitor and assess the adequacy of Fund resources through periodic liquidity reviews.