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INTERNATIONAL MONETARY FUND

Committee of the Whole on Review of Quotas

Meeting 87/1

4:00 p.m., Monday, July 6, 1987

M. Camdessus, Chairman
R. D. Erb, Deputy Managing Director

Executive Directors	Alternate Executive Directors
A. Abdallah	
Dai Q.	
C. H. Dallara	
J. de Groote	J. Prader
A. Donoso	
M. Finaish	
G. Grosche	
J. E. Ismael	J. Reddy
	J. Hospedales
T. P. Lankester	
J. Ovi	
M. Massé	
	C. V. Santos
Y. A. Nimatallah	I. A. Al-Assaf
G. Ortiz	
	S. de Forges
	J. de Beaufort Wijnholds
C. R. Rye	C.-Y. Lim
G. Salehkhou	O. Kabbaj
A. K. Sengupta	L. E. N. Fernando
K. Yamazaki	M. Sugita
S. Zecchini	N. Kyriazidis

L. Van Houtven, Secretary and Counsellor
B. J. Owen, Assistant

Also Present

Exchange and Trade Relations Department: S. Kanesa-Thasan. Legal Department: W. E. Holder, Deputy General Counsel; H. Elizalde. Research Department: R. R. Rhomberg, Deputy Director; P. Isard. Treasurer's Department: G. F. Laske, Treasurer; T. Leddy, Deputy Treasurer; D. Williams, Deputy Treasurer; P. Clark, S. I. Fawzi, Y. Kawakami, O. Roncesvalles. Personal Asistant to the Managing Director: R. M. G. Brown. Advisors to Executive Directors: P. E. Archibong, L. P. Ebrill, S. M. Hassan, G. D. Hodgson, A. R. Ismael, Khong K. N., J.-C. Obame, I. Puro, I. Sliper, D. C. Templeman, A. Vasudevan, J. E. Zeas. Assistants to Executive Directors: F. E. R. Alfiler, O. S.-M. Bethel, H. S. Binay, R. Comotto, E. C. Demaestri, F. Di Mauro, S. K. Fayyad, V. J. Fernandez, M. A. Hammoudi, M. Hepp, G. K. Hodges, A. Iljas, S. King, K.-H. Kleine, M. A. Kyhlberg, V. K. Malhotra, T. Morita, C. Noriega, S. Rebecchini, G. Schurr, G. Seyler, B. Tamami, H. van der Burg, Wang X., D. A. Woodward, I. Zaidi.

1. NINTH GENERAL REVIEW OF QUOTAS - QUOTA CALCULATIONS

The Executive Directors, meeting as a Committee of the Whole, considered a staff paper on the Ninth General Review of Quotas - Quota Calculations (EB/CQuota/87/1, 6/5/87; Cor. 1, 7/1/87; and Sup. 1, 6/30/87).

Mr. Grosche remarked that the staff paper provided an appropriate basis from which to start the Ninth Quota Review. The main conclusion that his authorities had drawn from the paper was that basically the formulas developed for the Eighth Quota Review had proved useful, continued to be applicable, and should serve their purpose well, that purpose being to provide a fairly good measurement of individual members' economic positions. Therefore, he agreed with the staff that "there do not seem to be strong reasons on this occasion to change the particular combination of formulas agreed in connection with the Eighth General Review." However, he was open minded, and would not object to a further discussion on the formulas, if new, strong reasons were put forward for doing so.

The fact that in a relatively large number of cases the staff had had to use estimated data because no reliable data were available was of some concern to him, Mr. Grosche added. Although he took some comfort from the staff statement that those shortcomings would in all likelihood not have any considerable effect on the calculations, he urged the members concerned to make every effort to improve their statistical data base to the extent possible.

At the current stage it would certainly be premature to draw any conclusions about the appropriate size of the Fund, Mr. Grosche observed. As the staff had rightly stated in paragraph 2 of its summary and conclusions, the quota calculations had a bearing mainly on the distribution of quotas and were less relevant for the consideration of the overall size of the Fund. He looked forward to the forthcoming paper that would assess the financial needs of the Fund in the 1990s in the light of the balance of payments problems and the financial environment that were likely to prevail in that period. For the time being, he would reiterate only the basic position of his authorities, namely, that the Fund should rely on quota subscriptions as the basic source of financing for its operations.

Reverting to the main subject under consideration at the present meeting, Mr. Grosche said that he had understood from the staff paper that there were many cases of relatively large disparities between members' shares in actual and calculated quotas. Although the scale of those differences had fallen as a result of the Eighth Quota Review, the quota shares of several members were still considerably out of line with their position in the world economy as indicated by the quota calculations. For that reason, it appeared appropriate to use the opportunity of the Ninth Quota Review to make further relative adjustments in quotas. As under the Eighth Quota Review, that result could be brought about by an appropriate mix of equiproportional and selective increases in quotas.

Mr. Ismael made the following statement:

I welcome this preliminary discussion leading to the Ninth General Review of Quotas. Let me state at the outset that the techniques and procedures used for the Eighth Review of Quotas are generally satisfactory and they could usefully be utilized for the Ninth Quota Review. The formulas incorporate key economic variables including GDP, official reserves, current receipts, and current payments. The formulas also take account of the variability factor in annual current receipts. These procedures and techniques are not perfect, and they may not produce the desired results for all member countries. But, on the whole, the range of data used in the calculations and the formulas used for the Eighth Quota Review do provide a reasonable indication of the relative strengths of the economies of member countries.

Turning to the staff paper, I have no difficulty with the first section which relates to the data used in quota calculations. I would, however, like to question the rationale for valuing official gold holdings at SDR 35 per ounce when all other forms of official reserve holdings are valued at current market prices. My own preference would be to adopt a uniform valuation method for all forms of reserves, including gold.

I note from Table 1 that, with one exception--namely, the variability in current receipts--the rates of growth of all other variables used in the quota calculations have declined significantly between 1980 and 1985 compared to the data for the previous five-year period on which the Eighth Quota Review was based. This slowdown in the growth of variables has been associated with the slowdown of growth in world economic activity and world trade and the decline in commodity prices and inflation rates.

One important consequence is the corresponding slowdown in the increase in total calculated quotas for the Ninth General Review. It will be important for the Board to take this factor into account in considering the size of quota increases under the Ninth Review so that, if there is any link between calculated and agreed quotas, we avoid compounding the problem of a relatively small increase in calculated quotas with an equally small percentage increase in agreed quotas under the Ninth Review. In deciding on the size of the quota increase under the current review, we must give due recognition to the fact that quota increases in the past have not kept pace with growth in the world economy, as reflected in the rapid fall over time in the ratio of actual quotas to calculated quotas. It is therefore important to have a substantial quota increase so that actual quotas of most members can be brought in line with their calculated quotas.

As for the quota formulas, undue instability in the structure of calculated quotas on the occasion of each review must be avoided. I therefore agree with the staff that the five-formula method gives a reasonably narrow range within which to measure disparities in the quota structure and to consider selective increases. I also agree with the staff conclusion that there are no strong reasons on this occasion to change the particular combination of formulas agreed for the Eighth General Review for the purpose of computing a calculated quota for each member.

As far as the divergences between calculated quotas and agreed quotas are concerned, I am happy to note that the emphasis given to selective increases in the Eighth Quota Review reduced the average discrepancy between calculated quotas and agreed quotas to 54 percent from 76 percent under the Seventh Review. While I believe that the disparities between calculated and actual quotas continue to be large, the magnitude of selective changes should be modest and smaller than on the occasion of the Eighth Review.

Finally, on the question of the key for distributing selective increases, I see merit in retaining the method used for the Eighth Review. Under this method, the calculated quota itself was used as the distributive key for the selective increases whereas the equiproportional increase was based on members' actual shares in quotas prior to the Eighth Review. This method has the advantage of providing an element of stability in the distribution of quotas among different groups of members.

Mr. Prader made the following statement:

With respect first to the appropriateness of the economic variables and techniques to be used for calculating the new quotas, we basically agree with the way the calculations have been made. At the present stage, we would change neither the criteria nor the weighting of the individual variables, nor the method used to derive a calculated quota for each member. The modifications in the variables and in the composition of the formulas which were introduced during the Eighth Quota Review represent substantial progress over the methods applied during earlier quota reviews. The individual variables in the formula clearly reflect the changes in countries' economic structures since the last quota review, and can still be considered reliable and useful indicators of each country's role in the world economy. In our opinion, the ability of the techniques used in arriving at the new quotas to take account of an array of diverse trends over time, and yet to show that the contributions of individual economic variables are more or less stable, demonstrates that this is a sound and well-chosen procedure for calculating the new quotas.

Of course, it would be easy to refine the present formulas by adding new variables, such as financial flows, by reducing the weight of variability, or by discussing at length the measurement of reserves. But what are the opportunity costs of such an exercise? Given the large role of judgmental factors in coming to agreement on quotas, more elaborate statistical discussions would provide only marginal benefits in terms of new information, while their cost in terms of delaying the Ninth Quota Review would be great. I also doubt that such elaboration would have much impact on one of the basic problems of any quota review, which is that the majority of member countries have quotas that are too high relative to their calculated quotas, while a minority have quotas which are too low. Therefore, we should not spend too much time adding new variables to the formulas for the quota review, but should rather concentrate on the mechanism for arriving at plausible quota figures that are an agreeable compromise for the Fund membership.

Moreover, statistical considerations are not the only reason for the Fund to stick to its present quota formulas: it is also desirable to preserve some continuity in the method used to determine quotas. Indeed, policies based on the principle of continuity have a much better chance of acceptance, since the underlying reasoning does not undergo frequent and subtle changes which could weaken confidence in the integrity of the decision-making process.

My second comment specifically concerns the discrepancies between actual and calculated quota shares. Even though these discrepancies appear to have narrowed somewhat, the problem persists. If the Fund wants to deepen the cooperative spirit of its work, it must continue trying to narrow the differences between actual and calculated quota shares. The Fund's goals and operating procedures require that a member's quota should truly reflect the member's actual share in the world economy, rather than having its basis in outdated historical data.

At the same time, it must be acknowledged that the determination of quotas involves questions which go far beyond pure economic calculations, and that the final quota figures will be based on a large judgmental element. I should therefore like to emphasize that these are arguments for narrowing, rather than for eliminating, the differences between actual and calculated quotas. The staff mentions that the last quota review was instrumental in eliminating some major individual imbalances that had been dragging on throughout consecutive quota reviews. Based on the experience of the last quota review, the harmonization of countries' shares will require a selective quota increase on top of a general increase. However, we must not underestimate the difficulties this necessary step involves. With the task of distributing quotas already made very difficult by the persistent imbalances in the distribution between surplus and deficit countries, the issue of a selective quota increase will require even more far-reaching compromises on the part of the Fund's members.

By comparing the impact of quota reviews on the quotas of the major country groups, Table 7 goes straight to the heart of this question. As the table shows, the previous quota review took place under the especially fortunate circumstance of a significant increase in the calculated quota share of the nonindustrial countries, making it easy to raise slightly their agreed quota share while simultaneously reducing the historical gap between agreed and calculated quota shares. Because the nonindustrial countries' share in calculated quotas and in the world eocnomy in general has been stagnant since then, it may now be more difficult to accommodate these two purposes simultaneously.

These considerations suggest that for the present review it might be a good idea to consider formulas for a selective increase that would only allocate additional quota increases to members whose calculated shares substantially exceed their actual shares, instead of applying the general redistribution mechanism which was decided for the Eighth General Review. One prerequisite for an answer to this question is scenarios showing the precise quantitative effects of various selective quota increases for the nonindustrial and industrial countries. Accordingly, I would like to invite the staff to reflect on the consequences of various selective increases, especially for countries with large differences between calculated and actual quotas, and to provide us with such scenarios.

Table 3 on the actual and calculated size of the Fund shows that the size of the Fund has been decreasing steadily since the Fourth Quinquennial Review in 1963/64, both in terms of calculated quotas and in terms of each of the variables contained in the quota formulas. The question to be addressed in the context of the upcoming in-depth discussion of the size of the Fund is whether a further relative decline has to be accepted during a period when the world economy is slowing down and a further widening of imbalances is in prospect. While most of us would agree that a certain relationship must be maintained between the size of Fund quotas and the growth of world trade, it would also seem desirable to pay attention to the relationship of quotas to the sum of world payments imbalances, since after all the use of Fund resources to alleviate these is proportional to the magnitude of the deficits.

I have a second comment here on how the relationship between the size of the Fund and the size of the quota increase is connected with the role of the quota increase in a situation where assurance of the Fund's liquidity relies increasingly on borrowing rather than on quota increases. It is our view that any shifts of this kind in the nature of the Fund's resources will produce changes both in the nature of the Fund itself and in the nature of countries' claims on the Fund, and that the Fund, being aware of this, should seek quota increases which will lead to a restoration of its normal financing modalities.

Let me also touch briefly on the quotas of Belgium and Luxembourg in my own constituency. Both countries very much appreciate the efforts the staff has already made in the direction of separate quota calculations for Belgium and Luxembourg. This change in procedure should help to align both countries' quotas more closely with the basic principle that a country's Fund quota should reflect its relative position in the world economy.

Finally, I have two general remarks that fall somewhat outside the scope of the document before us. If the question should arise again, as during the last quota review, of a trade-off between the timing of the quota increase and its size, our preference is for a higher increase. Also, as regards the question of payments to be made by members in SDRs, under Article III, Section 3 of the Articles of Agreement, we would favor an arrangement that would allow members to pay a large part of the increase out of an allocation of SDRs specifically designed for that purpose.

Mr. Yamazaki made the following statement:

I would like to begin by thanking the staff for the comprehensive and very useful calculations. The quota review consists customarily of two major elements, the size of the Fund and the quota share of members. It is a pity that today we have to start with the latter, since the former would shed more light on the time frame within which we have to discuss and complete this review. Under the circumstances, I would not now propose to go into detail on the procedural aspects and would rather concentrate on quota share issues on which I shall indicate my preliminary reactions to the methods adopted by the staff.

Before commenting on technical issues, however, I would like to emphasize the fundamental importance of the quota in Fund activities and the need for adequate capitalization if the Fund is to fulfill its function in the years to come. The Fund has played a central role in resolving the debt problem, and for the

Fund to continue to play this important role, its liquidity needs to be strengthened, in principle, through a quota increase. In view of this, my authorities intend to participate positively in the discussions on this quota review.

Quotas constitute the basis for determining various rights and obligations of Fund members. This being the case, a large discrepancy between the actual quota share and relative economic strength could lead to hindering the smooth functioning of Fund operations. As the staff calculations clearly indicate, the present distribution of quotas, which does not properly reflect the relative economic positions of member countries, needs to be rectified with urgency. My authorities are prepared to make a contribution to the capital increase commensurate with the economic strength of the country. If it turns out to be difficult to obtain agreement on a general quota increase at this review, there may still be room for considering special or selective increases for some members. In any event, my authorities are looking forward to seeing progress made in the Board's discussion on this important subject.

Now let me turn to the quota formulas. Like previous speakers, I can generally support the staff's view that there do not seem to be strong reasons to change the existing formulas as applied to the Eighth General Review. Nevertheless, I would like to emphasize that the use of national income or GDP, being the basic factor representing the relative economic position of member countries, would best serve the purpose of strengthening the Fund's financial position, since it is more closely associated, along with reserves, with the member's ability to make an effective financial contribution to the Fund's liquidity than other factors, including current account transactions or export variabilty. I, therefore, believe that at least the current weight for GDP needs to be maintained in the present review.

On the issue of data to be used in quota calculations, the staff calculations are based on data ended in 1985. While I am aware of the limitation of data availability, attention needs to be paid to the significant exchange rate changes that occurred among major industrial countries in the period between late 1985 and 1986. If 1986 data were used for calculations, the result could be substantially different from the one calculated by the staff. This suggests that the divergence between actual quota shares and calculated quota shares based on the most recent data may even be wider than that implied by the staff's calculations, thus heightening the urgency of selective quota increases. As a practical matter, I wonder to what extent it would be possible for us to incorporate 1986 data into our Ninth Review calculations, assuming that the review needs to be completed by March 1988. I would welcome any enlightenment by the staff on this point. I would expect the data to be updated, if the implementation of the quota increase should be delayed for some reason or another.

Commenting further on economic data entering into calculations, the staff has introduced a new adjustment for interest received and paid on international banking activities, which, according to the staff proposal, would be included only on a net basis in current receipts or payments. I would have welcomed a somewhat more detailed discussion on the economic rationale for this treatment and on the relative impact of such adjustment. In the meantime, my authorities are working on estimating such figures and may wish to request, when they are completed, that the staff incorporate them into its calculations.

Finally, on a minor point, the staff seems to have employed the method of valuing the ECU counterpart of gold deposits at market prices. I believe that the present method of valuing official gold holdings at SDR 35 per ounce should be continued and that consistency should be maintained in every respect, including that of the ECU counterpart of gold, even if such adjustment would have only a small impact on the calculated quotas.

Mr. Wijnholds made the following statement:

I welcome this opportunity to start discussing the modalities of the Ninth General Review of Quotas. This first discussion has to be a very preliminary one, of course, also because we do not yet have the staff paper on the size of the Fund. I hope that that paper will contain some material reminding us of the philosophy behind Fund quotas, which is not mentioned in EB/CQuota/87/1. While we are all supposed to know what that philosophy is, it would seem useful to have a reminder of what it entails, taking into account that the last quota review was held before most of the present Board members arrived in Washington.

The calculations presented in this first quota paper should be seen as an initial, technical examination focused on the distribution of quotas. Still, the paper contains a rather strong conclusion, namely, that no changes appear to be needed in the quota formulas or the method of calculating quotas. At the same time, it is suggested that many members' quota shares are out of line and that therefore considerable adjustments in relative positions are called for. While I agree with this latter point, I have some difficulty endorsing the view that present methods of calculation are still fully appropriate. Let me explain in which areas I feel that the present calculations raise important questions.

First, like Mr. Yamazaki, I note that the data used in the calculations appear to have been affected considerably by developments in the exchange rate of the U.S. dollar that are reflected in the SDR value against which national data have been converted. While the share in calculated quotas of the industrial countries as a group shows rather little change, there are quite substantial shifts within the group. To the extent that these reflect differences in growth rates and the growth of foreign trade, this is quite appropriate. But a considerable element of exchange rate effects seems to be involved as well. Gross domestic product for the last year of the period from which the various data are taken has a large weight in the formulas, and the exchange rate used to convert a country's GDP into SDRs therefore profoundly influences the outcome of the calculations. This is an undesirable feature of the present method of calculation. The exchange rate used might be severely out of line with underlying economic conditions, as indeed was the case with the dollar in 1985. To use that exchange rate would therefore result in quota calculations that are also out of line with those underlying conditions. I would therefore like to request the staff to provide us with alternative calculations that take away the distortion of the temporarily very high level of the dollar exchange rate in 1985, for instance, by using average exchange rates over the period 1980-85, or by some other means, such as using 1986 data, as suggested by Mr. Yamazaki.

A second issue concerns variability of current receipts. It seems to me that this factor has come to play an unintended role. The concept of variability was introduced to take into account the fact that various developing countries, highly dependent on commodity exports, are confronted with fluctuating commodity prices and export receipts. Their potential need to use Fund resources is therefore greater than it would otherwise be. The compensatory financing facility was introduced in recognition of this fact, and consequently the need to have a separate measure of variability in the quota formula lost much of its rationale. Furthermore, the present measure of variability not only reflects fluctuations in prices, but in fact highly rewards countries that have profited from large discrete price increases. Table 5 clearly shows that the contribution of variability to calculated quotas is many times larger for fuel exporters than for any other group. To the extent that fuel exporters' calculated quotas increase on account of the growth of GDP and their foreign trade, that is of course entirely appropriate. But to have their share further increased on account of variability I do not consider satisfactory. I would like the staff to look into ways to alleviate this unintended effect of the variability component. Perhaps we could consider limiting the use of the variability component to those countries for which it was really intended, namely, the primary product producers and, in addition, the services and remittances countries.

My third and final point is that I wonder whether, in view of the large current account imbalances of recent years, it is still desirable to accord more weight to current payments than to current receipts, as is the case under the Bretton Woods formula, which is the operative one for the larger countries, except the United Kingdom. This practice leads to relatively large calculated quotas for countries in prolonged deficit positions, which does not seem justified. To the extent that calculated quotas are reflected in actual quotas, a goal which my authorities strongly support in principle, the practice I have just described is not favorable to the Fund's liquidity position. I would therefore ask the staff to look into this problem to see how it can be rectified.

Mr. Massé made the following statement:

The staff paper provides a good basis for an initial discussion in connection with the Ninth General Review of Quotas. My views are necessarily preliminary as account must subsequently be taken of information arising out of the forthcoming staff paper on the appropriate size of the Fund. To the extent possible, the latter paper should try to examine the range of financing problems the Fund will have to address over the forthcoming period and the adequacy of its facilities, including the structural adjustment facility, to deal with them.

The evidence presented in EB/CQuota/87/1, including the roughly unchanged contributions of the individual economic variables used in the quota formulas, indicates that the multiformula system continues to be able to incorporate changes in the structure of members' economies over time. Consequently, we agree with the staff that there is no reason at this time to change the quota formulas or the method of calculating quotas.

Our overall view is that general quota reviews should be based on two principles. The first is to ensure that the Fund grows along with the world economy in a manner that permits it to carry out effectively the role set out for it in the Articles; and the second is to ensure that members' quotas reflect changes in their relative economic and financial positions in the world economy. As the paper points out, the updated calculations do not provide precise indications of the appropriate increase in the size of the Fund or of individual quota increases. There are, however, a number of observations that can be made at this point to help direct future work.

An initial point is that, as Mr. Grosche remarked, while we realize the need for the staff to use estimated data in many instances, we encourage the staff to monitor data sources and make revised calculations if the situation permits.

A general observation emerging from the calculations is that although the world economy continued to grow in the five-year period to 1985, the rate of growth of the variables used in making quota calculations, except for variability, is much smaller than that experienced in the preceding two decades. In terms of considerations regarding the appropriate size of the Fund in the years ahead, the evidence seems to be somewhat mixed. We will await the closer examination of these factors in the forthcoming paper on the size of the Fund before commenting further on the issue of the potential scale of the Fund and its activities.

We were pleased that, under the Eighth Review, progress was made on reducing the disparity between calculated and agreed quotas. We believe that a stronger and more equitable Fund results from individual quotas which closely reflect members' relative economic strength, and to this end it was appropriate during the last general review to give greater emphasis to selective increases. The current calculations indicate that despite a continued narrowing of the extent of the discrepancies between shares in actual and calculated quotas, a considerable number of relatively large disparities persists. The current review should address the situation of those members whose quota shares continue to be substantially out of line relative to their positions in the world economy. As a preliminary step, we would encourage the staff to give consideration to the methodology employed in the Eighth Review, perhaps by offering calculations of various combinations of selective and general increases.

We are aware that giving emphasis to selectivity can have considerable impact on the distribution of quotas for individual countries and among groups of countries. While the exercise of selectivity may be necessary, we also recognize a need for special attention to be given to countries with a small economic base. Several members of my own constituency will be greatly affected by an adjustment in quotas as calculated. The consequences in respect of access to Fund facilities are obvious and will be significant. The possibility of establishing some form of a floor in the amount of calculated quota shares, or a minimum increase in a member's quota, could be pursued by staff.

Finally, we should not create any major impediments to an improvement in the quota structure, but at the same time, we should realize that such a reordering is perhaps best implemented over several reviews.

The Acting Chairman then assumed the chair.

Mr. Zecchini made the following statement:

The staff has prepared a comprehensive set of data which in my opinion represents a good starting point for our discussion and deliberations. It is only a starting point because the commendable statistical work that the staff has done does not dispel all the doubts and uncertainty that surround this exercise. For instance, the staff mentions on page 4 of its paper that "the relatively large amount of staff estimation of the data...is a cause for some concern." Furthermore, not all the data used in the calculations are up to date. Yet the required improvements in the formulas are minor since, overall, they seem to capture most of the major economic developments which should affect our decision on quota increases. However, some discussion seems appropriate as to the weight to be assigned to some variables.

Before delving into these technicalities, a few general conclusions can be drawn from the statistical work of the staff. First, an increasing gap has emerged between the growth of the world economy and the size of quotas and therefore of Fund activity. We can use calculated total quotas as a proxy for the expansion of quota demand in the last five years since these reflect the increase in external payments, trade, and the degree of openness of individual economies as well as the slowdown in the expansion of GNP and of international reserves. In such a framework, we notice that since 1983 the distance of the actual quota base from the calculated one has increased to unprecedented levels. Today, the former represents only a little more than one quarter of the latter. Therefore, we see the need for a substantial increase in total quotas to restore a balance between the size of the Fund and the world's demand for its financial support.

The second conclusion which can be drawn pertains to individual national quotas. Although some of the disparities between calculated and actual quotas have decreased, there still exists a fairly large number of members whose actual quota deviates substantially from the calculated one. Consequently, in the context of the overall quota increase it is necessary to leave more room for selective increases. Let me comment further on this aspect before addressing some technical aspects related to the calculations.

The creation of room for selective increases is not independent of the size of the overall quota increase that will be decided, as no member can accept either a reduction or a zero increase based on the growth of its economy. The higher the overall increase, the easier it is to correct the current imbalances between individual calculated and actual quotas.

Furthermore, in deciding the overall size of the Fund, we should consider the appropriate relative weight to assign to the group of industrial countries compared to that for the nonindustrial country group. It is not advisable to substantially reduce the share of the industrial countries at a time when their actual total quotas continue to be lower than the calculated ones. If a reduction in the share of these countries is necessary to accommodate the needs of some nonindustrial countries, such a reduction has to be marginal.

With regard to the method to be used for selective increases, the one applied in the Eighth Quota Review has proved to be at the same time fair, simple, and effective. We have no objection to retaining the same method for the Ninth Review, possibly in the same proportions of 60-40 percent.

It is also important to recall that the Fund has decided to consider ways in which countries in arrears for a long period of time could be excluded from the quota increase. In fact, it seems contradictory to raise members' capacity to use Fund resources through a quota increase for countries that have clearly lost their creditworthiness or shown an unsatisfactory record of cooperation with the Fund. This issue concerning countries in arrears has to be solved before a decision is taken on the selective quota expansion.

Turning now to a few technical issues, first of all there is a need to strengthen the data base for the quota calculations. As far as Italy is concerned, we cannot accept the calculations presented by the staff because they are based on old national accounts data which have been extensively revised at the beginning of this year. My authorities have already transmitted the new data to the Fund and we expect that a correction of the calculations pertaining to my country's quota will be issued very soon by the staff.

As to the quota formulas, the multiformula system seems to include most, if not all, the economic variables that are relevant in our exercise. However, the relative weights assigned to some variables may be questionable. Specifically, the coefficient for variability of current receipts still appears relatively large as it tends to magnify the impact of large discrete changes in prices. To correct this distortion, we could consider either reducing the size of the coefficients by a specified percentage across all the formulas or dropping formulas with the highest variability coefficient, namely, schemes M4 and M7, from our calculations.

In conclusion, we think that the staff has to complete its statistical work on data and, if possible, on formulas very quickly in order to allow us to progress in our deliberations, aiming at toth a general and a selective increase.

Mr. Lankester commented that Directors had not yet had the benefit of seeing the staff's work on the size of the Fund, and he looked forward to the paper on that subject. Meanwhile, he would confine his remarks to the issues covered in EB/CQuota/87/1, after making a suggestion for a further paper. If the issue of the formulas were to be reopened, much ground that had been extensively covered in the past would have to be gone over.

For those who had not been involved in previous reviews, it was fairly difficult to find a concise account of the discussions that took place during the Eighth Quota Review, Mr. Lankester added. He wondered therefore whether it would be possible for the staff to circulate a background paper summarizing briefly the course of those discussions.

On the matters raised in the staff paper under discussion, he did not think that anyone could regard the formulas as perfect, or even could produce an entirely convincing theoretical rationale for their structure, Mr. Lankester observed. However, he could also see that the formulas represented a compromise between various factors and interests. Some interesting points had been made in that connection but he had not been convinced by anything that had been said that the question of the appropriateness of the formulas was worth reopening in the current review. For instance, to take the suggestion by Mr. Wijnholds and Mr. Zecchini that the variability coefficient should be reduced, he recalled that the reduction of that coefficient by 20 percent in the Eighth Quota Review was part of a fundamental reassessment of formulas that was intended to be durable. After all, the variability of current receipts was a relevant indicator of members' potential need to draw on the Fund. On balance, he would not be inclined to reopen the issue of the appropriateness of the formulas during the current review.

As the staff's latest calculations made clear, the general extent of the discrepancies between shares in actual and calculated quotas had narrowed somewhat, Mr. Lankester noted. However, significant disparities remained, and his authorities would in principle be willing to see some further modest relative adjustments in quotas under the Ninth Review. At the same time, they would still expect the overall quota increase to be allocated on a fair and nondiscriminatory basis.

Mr. Abdallah made the following statement:

> The staff paper on the calculations of quotas is of great importance to the Fund membership in general and to the developing countries in particular. I note that for the various computations, the variables and formulas used for the Eighth General Review have been applied. The outcome as gleaned from the tables, particularly Table 9, indicates that most members' calculated shares have fallen below their existing shares. This is the case for virtually all developing countries.

It seems to me that the weaknesses inherent in the existing method of quota calculations exert a greater loss on relative shares of developing member countries. First, the lack of availability of official data for reserves and GDP estimates for a number of developing countries tends to compel reliance on staff estimates which may not be very reliable and is also undesirable, as Mr. Grosche has commented. Another strong argument for using more recent data is that mentioned by Mr. Yamazaki and Mr. Wijnholds, namely, the need to take account of recent major changes in exchange rates.

Second, the mechanics of quota calculations could be further improved to take account of how some recent developments affect developing countries in particular. In the current global environment, there has been marked volatility in the prices of both real and financial assets and, as a group, developing countries are major exporters of primary commodities with large price fluctuations. To reflect these developments adequately, the coefficients for variability could be restored, at a minimum, to their levels during the last review in 1982-83. It will be recalled that variability was of little concern until the 1970s when the sudden large increases in the prices of certain commodities, beginning with the first oil shock in 1973, sharply increased the contribution of this variable to the quota formulas. Because it was thought that the behavior of current receipts, which showed rising price trends for most commodities, with minor deviations for some, would persist, the coefficients for variability of current receipts were reduced by 20 percent during the Eighth General Review of Quotas. However, current swings, particularly in commodity prices, warrant an adequate restoration of coefficients for variablity, at least to their former levels.

It is also obvious that a small island economy or a country with a relatively low per capita income is likely to experience greater balance of payments difficulties and, therefore, to have greater need of Fund assistance than a country with a relatively higher per capita income. One method for safeguarding the interests of such countries is to set a floor to their quotas as suggested by Mr. Massé, or to include some form of poverty index, as suggested by some Directors at the Sixth Review of Quotas in 1972-73. In view of the currently deteriorating international environment, the argument for including a poverty index in the quota formulas is even stronger.

The results of quota calculations presented in Table 3 reveal some interesting facts. The rapid decline in the ratio of actual to calculated quotas over time, and the magnitude of the excess of total calculated quotas over the total of actual quotas agreed at the Eighth General Review, clearly indicate that the growth of quotas has not kept pace with the growth of the world economy. It also reveals the decline in the size of Fund quotas relative to the size of the world economy as measured by calculated quotas. Yet developments in the world economy, changes in its structure, and the resultant financing requirements of developing countries necessitate an increase in the size of quotas and a modification of the ways in which they are measured and distributed. These are some of the issues that the ongoing Ninth General Review of Quotas should seek to address.

Finally, let me say that I strongly support the proposal made by Mr. Prader that the quota increases that will ultimately be agreed under the Ninth Quota Review should be financed through a special allocation of SDRs.

Mr. Nimatallah said that he welcomed the start of the Ninth Review of Quotas and that he looked forward to the paper on the size of the Fund and to its discussion by the Committee. He was one of the few Directors present who had experienced the long and tedious process of the Eighth Review that had led to the existing techniques for calculating quotas. Therefore, he agreed with the staff that there was no reason to change the present method--either the number and structure of formulas, or the relative weight given to each component in the individual formulas. He agreed also with Mr. Lankester that the set of formulas and the coefficients of variables were a result of a delicate compromise, and that it would be prudent not to disturb that compromise. He cautioned those who wanted to tamper with either the structure of the formulas or the coefficients of their components would have to wait a long time to see any different results.

Finally, Mr. Nimatallah said that he hoped that members having a wide discrepancy between their calculated and actual quotas would have a chance in the Ninth Review to narrow that discrepancy, if not in full at least in part. He invited the staff to begin looking into that matter as early as possible.

Mr. Hospedales made the following statement:

We welcome this paper on calculations in connection with the Ninth General Review of quotas. We believe that these preliminary discussions--and our comments will therefore be more or less of a tentative nature--could be extremely helpful in establishing a framework of action for accelerating the procedures for completing the Ninth Review of Quotas. We regard this as a matter of high priority. While we are fully aware of the difficult nature of the work, we expect the increase to become effective as soon as possible.

The staff has taken a sensible approach at this stage of the discussions. They have not charted new courses nor have they pursued an illusory quest for one or two formulas; essentially, as a starting point, the paper has utilized the same techniques and procedures that were agreed upon during the complex and delicate negotiations which governed the Eighth General Review. Accordingly, they present calculations of quotas for members using end-1985 data which provide guidance, first of all for exploring the appropriate size of the Fund, and second, for determining whether relative adjustments are necessary in view of the changes in members' relative economic and financial positions. We look forward to a more detailed discussion on these issues in the coming months.

The choice of a set of formulas, in our view, is only the first step in allocating quotas. The multiformula system used in these calculations was considerably simplified and modified during the Eighth Review and, while still somewhat imperfect, seems to be working as intended on the basis of the present calculations. In any event, what is strikingly clear from the statistical calculations is that a substantial increase in quotas is wholly justified in current circumstances. Such a course of action will be in line with the general consensus that the Fund should be an institution based on quotas sufficiently large to enable it to discharge its responsibilities.

We are well aware, and the staff paper has supported this view, that since the Fifth Review, quotas have not been keeping pace with developments in the world economy, as the ratio of actual quotas to theoretical quotas has been falling rapidly. In fact, the calculated size of the Fund, at SDR 329 billion, is now 3.65 times the actual size of the Fund--SDR 90 billion--whereas at the commencement of the Fifth Review in 1969, the calculated size was only 1.45 times the actual size. In addition, the magnitude of the excess of calculated quotas over the total of actual quotas agreed at the Eighth General Review has widened when compared with the excess at the commencement at the last review. Finally, another key indicator of the inadequacy of Fund resources, the ratio of Fund quotas to current account payments, has been on the decline, averaging approximately 4 percent in the period 1981/85 compared with an average 8.5 percent following the three previous quota reviews. By these measures, the case for a substantial increase in quotas is overwhelming.

It is our view that insufficiency of quotas and the consequent inadequacy of funding have inhibited the ability of the Fund to help solve a country's adjustment problem and to solve it quickly. Accordingly, Fund policies have dictated too rapid an adjustment, entailing substantial import compression, stagnation of economic activity, and general deflation. The resource stringency may even have been responsible for the cumulative decline in access limits as well as the restrictive interpretation of the Articles of Agreement, thereby placing undue emphasis on the temporary nature of Fund financing and the revolving character of its resources.

On the general question of the future distribution of quotas, we have noted a relative stability in the distribution of calculated quotas and also that the disparities between actual and calculated quotas have narrowed somewhat. We wish merely to state that any shift toward harmonizing shares must attribute increases to the widest range of countries so as to avoid abrupt changes in the quotas and voting shares of each member and major groups of members. For this reason, we must preserve an appropriate balance in quota shares and, therefore, in future allocations of SDRs, the distribution of voting power in the Fund, representation in the Executive Board, and the relationhship among members or particular groups of member countries, all of which depend on the distribution of quotas. In this connection, I wish to support the views expressed by Mr. Massé and Mr. Abdallah that due regard should be given to the position of countries with very small quotas in the Fund. I also wish to support Mr. Prader's call for an allocation of SDRs to finance the envisaged increase in quotas.

Mr. de Forges made the following statement:

As we are just starting the process of reviewing the Fund's quotas, I shall try to outline the basic considerations which, in our view, should have a bearing on this complex exercise. I shall thus comment on the overall size of the Fund and on a few principles that should be retained in distributing the general increase in quotas. In addition, on more technical grounds, I would like to suggest some alterations of the formulas used for quota calculations.

My authorities are concerned about the steady decline in the size of the Fund in relation to the world economy. All the relevant indicators point in this direction, as is clearly documented in Table 3 of the staff paper. Like previous speakers, we await the paper on the Fund's financial needs in the 1990s before forming a firm opinion. Nevertheless, in the meantime, my authorities would like to express their strong adherence to the quota-based character of this institution. We still consider that the Fund should be constantly endowed with the resources that would allow it to fulfill its functions in an optimal manner. In order to reverse the trend we witnessed during past years, and as a means of illustration only at this stage, a reasonable objective would seem to be to restore the ratio of actual to calculated quotas that prevailed after the Seventh Review. If such a general increase proved difficult to achieve, a compromise could certainly be reached between this ratio and the ratio that resulted from the Eighth General Review.

Along the same line of reasoning, my authorities are of the view that the distribution of the general increase should rely more heavily than in past quota reviews on calculated quotas, so that the Fund's structure reflects, as much as possible, the relative strength of member countries. Such an approach requires that the increase under the Ninth Review should be more predominantly selective and less equiproportional than on past occasions.

The first alteration of quota calculations that we have in mind could also go a long way in securing a better link between actual economic trends and Fund quotas. I am not referring here to the influence of large exchange rate movements, but to the price of gold. Without violating the Articles of Agreement, the Fund should use a less unrealistic valuation than the present US$35 per ounce in order to better take account of this still very important reserve asset. Such an amendment would benefit primarily the industrial countries at the expense of the developing countries. One way to counterbalance this impact could be to slightly reduce the weight ascribed to GDP in the various formulas.

A second change that we would suggest has to do with the variability factor. It is clear that the developments that took place on some major commodity markets during the first half of the 1980s have contributed to inflating the role of this factor. It would seem advisable to scale down slightly the contribution of this variable in calculated quotas. We would thus support a reduction of the weight of this factor to the level agreed upon for the Eighth Review, namely, from 16 percent to 14 percent.

Mr. Dallara made the following statement:

As this meeting represents our first gathering as a Committee of the Whole, I would like to make a few general comments before making some specific observations on the paper before us. As in the case of many other Directors, my comments today are necessarily preliminary. A general review of the Fund's quotas is a difficult and complex process. Fortunately, we are in a healthy position to conduct a thorough review. Not only is our current liquidity position strong, but the projections in the period ahead suggest little substantial change. It was against this background that Secretary Baker remarked to the Interim Committee this past

April that we have time to consider the issues carefully, and that we believe it is neither financially necessary nor politically feasible to reach an early conclusion to the Ninth Quota Review.

I found the paper before us interesting but, like Mr. Yamazaki, I perhaps would have preferred that it not be the first paper presented for our initial quota discussion.

There are, among many other questions, two basic questions which must ultimately be faced in any quota review: whether a quota increase is needed and, if so, what size is appropriate, leaving aside for the moment the distribution issue. Before one can begin to consider these questions, one must have a sense as to what role the Fund should play in the international monetary system. Looking back, the last quota review was concluded, in fact rather hurriedly, during the early months of the emergence of international debt problems. Since that time, considerable progress has occurred in dealing with the debt problem, although many difficulties remain. The international debt strategy itself has been strengthened and evolved further. Part of this strengthening has been an enhancement of the World Bank's role in the debt strategy, while preserving the Fund's central role. Along the way, we have developed new techniques and procedures, such as enhanced surveillance.

During these years, the Fund's role in low-income debtor nations has also evolved, with substantial lending in the earlier part of this decade being followed necessarily now by a period characterized, in part, by repayment to the Fund.

At the same time, we have seen an evolution of the Fund's role in industrial countries, with more comprehensive, in-depth Article IV consultations, a general strengthening of surveillance, both multilateral and bilateral, and a continuing lack of use of Fund resources by these countries which dates back to the 1970s. There has also been, and perhaps this is relevant in a general way for this exercise, a renewed interest in strengthening the framework for international economic collaboration, through the use of economic indicators.

These, and, of course, many other developments have implications for the Fund and raise questions requiring thought and analysis. For example, how can the Fund effectively play its catalytic role in the changing world environment, continuing to ensure that private sources of finance play their role, and that private participants fulfill their responsibilities? What steps need to be taken to ensure the Fund's revolving character?

On this point, let me make an observation related to one made earlier by Mr. Zecchini. He pointed to the need for the Board to focus on the question of how, in the context of a quota review, one should treat countries in arrears. I think that there is an issue here which is even more fundamental than the one to which Mr. Zecchini alluded. In fact, it is difficult for me to envisage a quota increase occurring in the context of the sizable, indeed growing, arrears problem that we face. As a Board, and as members of an institution which is uniquely cooperative in character and in financial structure, we must acknowledge the gravity of the problem and intensify our efforts, individually and collectively, to resolve it. It is obvious now that some members are currently unable to meet all of their obligations to the Fund on a timely basis. But this does not relieve them of the obligation, and certainly this provides no basis for the total, or virtually total, nonpayment to the Fund which has unfortunately characterized the position of some members in recent years and months. This arrears problem, and frankly the attitude of some members in particular that are in arrears, is quite inconsistent with the basic cooperative nature and purposes of the institution, and we should not tolerate it.

We recognize, of course, that it was not the intention of the present staff paper to address many of the broad questions to which I have referred. We understand, in fact, that a separate paper is being prepared which will consider the size and role of the Fund, and we hope that these, as well as other broad issues, will be considered carefully in that or subsequent papers.

Turning to the paper at hand, we recognize that a comprehensive review of quota formulas occurred earlier in the decade. But we do believe that the Board could benefit from further background on the formulas than is provided in this document. Mr. Wijnholds and Mr. Lankester have suggested that additional information and background might be useful, in particular for those members of the Board who did not participate in the last quota review. Even for those of us who participated in it, memories may have faded somewhat--I know my own has. And as I studied this particular document, I tried with some effort to recall the many individual debates and discussions we had in this Board, without, I am sure, being totally successful. In addition to the other suggestions that have been made, I would be appreciative if the staff could provide us with a historical review--perhaps this could be done on the basis of documents prepared earlier for previous reviews--of the rationale for the choice and weighting of the variables in the various quota formulas, the development or evolution of the alternative formulas, and the way in which the formulas and weights have been used over time.

I would be among those Directors (although I take it Mr. Nimatallah does not include himself among them) who believe that some review of the formulas is needed on this occasion. I would recall in that connection that during the Eighth Quota Review, when a substantial and thorough review of formulas was conducted, the report of the Board to the Board of Governors dated February 24, 1983, noted that some Directors felt that even with the revisions incorporated in that quota review, the formulas did not provide a wholly satisfactory measure of relative economic positions. It was understood in that report, in fact, that the changes that were made did not preclude further changes in connection with future reviews.

What are some of the changes which we believe merit at least consideration? First, we believe that consideration should be given to the possible inclusion of some measure of capital transactions. We recognize, of course, that, to a large extent, the capital account is a mirror image of the current account. Nevertheless, we do not believe that the long-term capital account is always adequately reflected through current transactions nor, in our current system, do we believe that reserves are always a particularly good proxy for short-term capital flows. It is, in fact, somewhat paradoxical that the capital account--at a time when it is the subject of increasing attention, as we deal with the imbalances of the major industrial countries and the problems of many of our debtor countries--receives so little attention in the formulas which we use to determine or to help guide us in determining quotas. We realize that data problems may exist here. Nevertheless, we believe that some analysis of this issue is called for.

Second, and a point more specific to my own country--as well as perhaps other countries which issue reserve currencies--has to do with the way in which reserves are treated in the formula. In the operational budget used to determine the use of resources in Fund transactions, exceptional treatment is currently provided for use of the dollar. The rationale--and I quote from one of the operational budgets--is "in view of the position of the United States in providing the major currency and the fact that its gold and foreign exchange reserves are not an adequate measure of the ability of the United States to finance a reserve tranche position in the Fund."

If that rationale is not an adequate one for use in guiding decisions regarding the use of the dollar in the operational budget, then it would seem to me that it is also highly questionable that use of reserves for the United States or, for that matter, for other reserve currency countries, is necessarily appropriate in determining quotas. It should be noted, for those who may not be as familiar with the subject, that with regard to every other member of the Fund, the ratio of reserve tranche positions over gold and foreign exchange holdings is used to determine the use of that member's currency in the operational budget. The issue seems to us to warrant consideration, not only in light of the treatment of the dollar in the operational budget, but also in view of the need to recognize the differences which exist between reserve currencies and nonreserve currencies, and the implications that may have for the ability of a member over the long run to provide financing to the Fund.

Third, like Mr. Wijnholds, Mr. Zecchini, and others, we believe that further scrutiny is called for regarding the role of variability. We recognize, as Mr. Lankester has pointed out to us, that a significant change in the role of variability of export receipts was made in the last quota review. But the importance of this factor has grown substantially in the recent period, and we believe that it would be appropriate for the staff to explore the economic issues regarding the role of variability, including the point made, which is well taken, that this could be a useful indication of the potential need to use Fund resources, as well as to explore the implications of alternative measures of variability.

Fourth, my authorities would appreciate consideration of alternative methods of treating offshore interest payments and receipts referred to on page 3 of EB/CQuota/87/1. We believe that attention needs to be given to a proper way of measuring the importance of interest payments and receipts, and that it is a difficult question as to whether there is a legitimate distinction to be made between offshore and onshore transactions and, if so, how to make that distinction.

Mr. Ovi made the following statement:

Although a discussion of quota formulas can be made very technical, it is rather obvious that in the end the technicalities will have to be judged against some sort of desired outcome. Therefore, I would like to offer some preliminary comments on each of the various issues involved in any quota discussion: the size of the overall quota increase; the adequacy of the present quota formulas for calculating the distribution of quotas; and the relationship between general and selective quota increases.

First, as to the total quota increase, the calculations before us point very clearly to a slowdown in the difference between calculated and actual quotas when compared to similar situations in the past. However, in my view, this does not prove that the average quota increase necessarily has to be lower this time. The ratio of actual quotas to calculated quotas has dropped sharply over the years. This applies in particular to the last quota increase when, in the end, we had to settle for a result well below that which an overwhelming majority of member countries, including this chair, could see good arguments for. Furthermore, the Nordic countries would generally favor a return to a situation in which the Fund can finance its lending policies basically from quota means only.

Second, as to the adequacy of the present quota formulas, an analysis of the results contained in the staff paper seems to indicate certain basic trends. As first noted by Mr. Wijnholds, the most important one seems to be a marked increase in the variability of current receipts, in particular for the oil-producing countries. Still, as the staff suggests, there seem to be a number of valid reasons for not changing the quota formulas again. In my view, the formulas should be as simple as possible, since the calculations can be no more than guidelines for the actual quota determination process. Therefore, unless there are major indications of instability in the entire quota calculation system, it appears desirable not to change the formulas. The simplification we attained during the Eighth Review could otherwise soon be lost.

Most important of all, the overall results of the present calculations seem quite satisfactory. Although this outcome is due to a great extent to the high share of selective quota increases in the last review, it is remarkable that the divergences between calculated and actual quotas turn out to be considerably smaller than in the past. This is certainly true judged by quota weights. But also when considering the cumulative quota share of industrialized and developing countries, respectively, it is very positive to note that these shares are now much more in line with the actual ones than before. As indicated by the staff, the largest discrepancies are now concentrated on a relatively small group of countries with fairly high quota shares.

In sum, I believe there are strong arguments for retaining the present quota formulas for the forthcoming review.

Third, on the question of general and special quota increases, it follows logically from what I have just said, that there seems to be a good case for using only a relatively small part of the overall increase for correcting imbalances through selective quota increases under the Ninth Quota Review. As to the system for allocating such selective increases, it is far too early to form an opinion.

Mr. Sengupta made the following statement:

The first staff paper before us today on quota calculations under the Ninth General Review serves two broad purposes. First, the calculations indicate the overall growth of the world economy, and second, they have been used to gauge the relative economic position of Fund members in the world economy.

The period 1980-85, however, has seen vast fluctuations in global activity. From a deep recession in the early 1980s, the industrial world entered into a sharp expansion, but the level of activity then started to taper off quickly. Prices and interest rates, which were at a peak in the early 1980s, came down. The U.S. dollar had attained such a strong value that the international trading, monetary, and financial systems were subjected to severe frictions. Much of the developing world fell under severe debt and balance of payment burdens and found external financing in general difficult to obtain, except at high cost. Some low-income developing countries, especially in sub-Saharan Africa, suffered untold miseries and human deprivation.

All these changes were not the result of the operation of normal factors. Indicators based on the movement of variables such as current payments, or GDP converted into SDRs by using exchange rates that were not only unstable but also misaligned, are not necessarily the right indices of the size or the relative position of the different countries. I submit that trends in the world economy need to be considered in any review of the distribution of quotas among members. Before we agree to accept the existing, or any other formulas, the Committee should have a thorough discussion, with the assistance of Fund studies, of the appropriateness of these formulas in fairly reflecting the changes in the world economy. Besides, the quota review should clearly serve the purposes for which it is intended.

To recapitulate, quotas serve four purposes: to determine the use that a country can make of the Fund; to determine the contribution it may have to make to the Fund's resources; to determine its voting power; and to determine SDR allocations. Past experience shows that the Fund has functioned so far in such a manner that the first two of those purposes have been served only partially so far. The latter two purposes have hardly been met. Depsite what Mr. Grosche has said, and as indicated earlier in the G-10 report, it is not clear to what extent the industrial countries intend quotas to perform the function of providing all the resources needed by the Fund, given the existence of the General Arrangements to Borrow (GAB), and given the willingness of members in strong positions to provide loans to the Fund under special borrowing arrangements. The Fund may not continue to rely heavily on borrowing in the near future, but in determining the importance to be attached to the financing function of quotas, the quota review and the appropriateness of the formulas are integrally related to the proposed size of the Fund, which again depends on the role we expect the Fund to play in the coming years.

The purpose served by quotas in determining members' use of Fund resources is the most important for the review. Accordingly, the formulas, and the size and distribution of quotas, should all be evaluated from this angle.

According to the staff paper, the quota calculations, using the same variables and formulas employed at the time of the Eighth General Review, show that fewer than 40 members obtain calculated shares higher than their existing quota shares. Of these, 13 members belong to the industrial country group, whose combined calculated share of total quotas is placed at 53.453 percent, against their current quota share of 47.416 percent. All the G-7 countries, other than the United Kingdom and Canada, are shown as having improved their calculated quota shares compared with their actual quota shares. Among the 25 developing countries that have improved calculated quota shares over their actual quota shares, 14 are fuel exporters, 2 are exporters of manufactures, 2 are primary product exporters, and 7 are countries which are predominantly dependent on services and remittances. My calculations show that of these 25 developing countries, only 3 are low-income developing countries--as they are defined for purposes of eligibility to use the resources of the structural adjustment facility--and their combined calculated share would be 0.109 percent of total quotas as against the existing share of 0.067 percent. Even if one were to compare the calculated shares for the Ninth Review with the calculated shares for the Eighth Review, the low-income developing countries' position has not shown much of an improvement. My calculations show that the combined calculated quota share of those low-income countries that improved their relative share would be 3.45 percent under the Ninth Review compared with their combined calculated quota share of 3.205 percent under the Eighth Review. I may also point out that a number of low-income developing countries would have lower calculated quota shares in the Ninth Review than their existing quota shares. It is obvious from these figures that the calculated quota shares, based on the current formulas, do not reflect the importance of the users of resources.

The staff has argued that there are no strong reasons at this time to change the particular combination of formulas used in the Eighth Review as a basis for the determination of a single calculated quota for each member. But as I have pointed out, world economic trends during the first half of the 1980s suggest a need to impart a sense of realism into the quota structure from the point of view of serving its purposes and improving the functioning of the international monetary and financial system. For this to happen, considerable thought has to be given to the decision-making process in the Fund, as well as to the criteria that take care of the interests of countries that often have to approach the Fund and use its resources for purposes of orderly, growth-oriented adjustment. In this connection, the 1985 G-24 report on The Functioning and Improvement of the International Monetary System advocated the need for a better balance in the voting pattern to achieve a more equitable and effective functioning of the Fund, and recommended an increase in the share of developing countries in total votes from about 38 percent at present to 50 percent. This report, as well as the G-24 report of June 5, 1987 on the Role of the IMF in Adjustment with Growth, sought a Fund that was essentially a quota-based institution. The June 1987 report (paragraph 86) suggested in particular that: "The inclusion of some form of 'poverty index' in the quota formulas merits consideration. Low-income countries are likely to experience greater balance of payments difficulties because of the severity of their structural rigidities, and they therefore need relatively more Fund finance. Inclusion of a poverty or per capita income index would better reflect the circumstances of these countries and would allow a level of quotas corresponding more closely to their financing needs." The idea is to ensure that the quota shares of countries with low per capita incomes would be proportionately high.

Let me on this point venture to be a little more detailed, without precluding the Fund staff from using its vast resources and talent to come up with its own suggestions in this respect. It may be useful to incorporate the reciprocals of per capita income as an important variable in the calculation of quotas. As a first step, each country's reciprocal of per capita income may be divided by the total sum of all countries' reciprocals of per capita incomes, to arrive at ratios from which a set of quota shares can be derived. The per capita income-based quota shares could be combined thereafter with the present staff calculated shares with equal weights. I would request the staff to look into the matter and provide calculations.

The variables in the quota formulas, and the coefficient values of the variables eventually used, also need to be closely looked into. Moreover, it is not clear why a sample period of 13 years (1973-85) is chosen for defining the variability of current receipts. Besides, there is the question of having GDP of a particular year in the formulas. It may be of use to see whether the rate of growth in GDP could be incorporated for the period, instead of for only one year, especially since GDP in nominal terms could give an underestimation in SDR terms, if the country in question follows the Fund's advice to depreciate its currency against the SDR. These matters should be examined once again. In the next set of staff papers, in view of the shifts in world economic trends during the first half of the 1980s, and in the light of the G-24 recommendations, we should focus on the role of the Fund, especially the size of quotas and the matters I have just raised.

Mr. Dai made the following statement:

I welcome the opportunity to discuss the Ninth General Review of Quotas, as I am convinced that an early agreement on this important matter will have a profound impact on the world economic problems facing us today and sustainable growth of the world economy in future.

In my view, there are two fundamental principles that need to be considered and agreed upon before we begin our discussion on the specific issues relating to the quota review. These principles are that of determining the size of the overall increase in quotas, and that of guiding the distribution of quota increases.

The latest calculations again indicate that the growth of quotas has not kept pace with the growth of the world economy. According to the table in the staff paper, since the Sixth General Review of Quotas, actual quotas have shown large and growing deviations from the growth of the world economy, and the gap between actual quotas and calculated quotas has greatly widened. The increasing gap between actual Fund quotas and the growth of the world economy and calculated quotas gives rise to the question whether it is the size of actual quotas or of calculated quotas that represents the true picture of the Fund's financing needs and/or the need resulting from expanded world economic growth. Furthermore, if the gap continues to increase, it would certainly cast doubt on whether the formulas we have been using are realistic and practical. I believe that the gap between actual quotas and calculated quotas should be narrowed by substantially increasing the total size of Fund quotas, if the calculated quotas really can be regarded as useful indicators.

This does not mean that at the present stage there should be a change in quota formulas or in the method; however, these techniques should be applied more dynamically rather than mechanically in the calculation of quotas. Therefore, I would like to suggest the following ideas as a starting point for the discussion of the current general review of quotas:

(1) The size of total Fund quotas should be compatible not only with present economic conditions but also with medium-term world economic growth.

(2) Present financial needs should have first priority when deciding on the actual size of total Fund quotas. However, at the same time, possible financing needs arising from economic developments over the next five years should be taken into account.

(3) As already stated by many Executive Directors, the basic principle of relying on general resources from quota contributions to finance balance of payments adjustment programs should be preserved, and the tendency to increase reliance on borrowed resources should be reversed. It seems logical, therefore, for the current quota review to work in that direction.

(4) The spirit of cooperation and the principle of mutual benefit should be kept in mind in dealing with the present quota review. Large extremes in quota distribution between the rich and poor member countries should be avoided as much as possible.

(5) It is essential that both the historical background and current economic conditions be taken into account when considering the distribution of quotas.

Finally, a satisfactory general review of quotas calls for genuine political will on the part of all member countries, especially those with the largest quotas. Without such political will, it could be very difficult to reach a compromise and quick agreement, as in the case of SDR allocations.

Mr. Finaish said that he had three points to make. First, there was need and justification for a substantial increase in the size of the Fund, a subject that would be discussed at a later stage. Second, he agreed with those Directors who saw no strong reasons for a change in the existing quota formulas. Third, on the question of variability, to which some Directors had referred, he saw no justification for a revision that would affect the weight of that factor negatively. Extensive calculations had been made in the past, and the subject had been discussed at length.

The Committee members agreed to resume their discussion the following morning.

APPROVED: January 14, 1988