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INTERNATIONAL MONETARY FUND

Committee of the Whole on Review of Quotas

Meeting 87/2

11:30 a.m., July 7, 1987

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

Executive Directors	Alternate Executive Directors
	S. M. Hassan, Temporary
Dai Q.	
C. H. Dallara	
	J. Prader
A. Donoso	
M. Finaish	
G. Grosche	
	J. Reddy
	J. Hospedales
T. P. Lankester	
	G. D. Hodgson, Temporary
	C. V. Santos
Y. A. Nimatallah	I. A. Al-Assaf
G. Ortiz	
J. Ovi	
	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	
S. Zecchini	N. Kyriazidis

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

Also Present

Legal Department: P. L. Francotte. Research Department: R. R. Rhomberg, Deputy Director; P. Isard. Treasurer's Department: F. G. Laske, Treasurer; T. Leddy, Deputy Treasurer; D. Williams, Deputy Treasurer; P. B. Clark, S. I. Fawzi, Y. Kawakami, O. Roncesvalles. Personal Assistant to the Managing Director: R. M. G. Brown. Advisors to Executive Directors: L. P. Ebrill, J.-C. Obame, G. Pineau, D. C. Templeman, A. Vasudevan, J. E. Zeas. Assistants to Executive Directors: A. R. Al-Abdullatif, F. E. R. Alfiler, O. S.-M. Bethel, S. K. Fayyad, V. J. Fernandez, M. A. Hammoudi, G. K. Hodges, S. King, K.-H. Kleine, M. A. Kyhlberg, V. K. Malhotra, T. Morita, C. Noriega, S. Rebecchini, G. Seyler, S. Rouai, H. van der Burg, Wang X.

1. NINTH GENERAL REVIEW OF QUOTAS - QUOTA CALCULATIONS

The Executive Directors, meeting as a Committee of the Whole, resumed their consideration of 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. Donoso made the following statement:

> The Ninth Review of Quotas will define the level of total quotas and its distribution in shares among members. The calculations we have been presented with give a clear indication as to what we should do with respect to the total size of quotas. If we consider the level of quotas that would result from the direct application of the Bretton Woods formula and compare that with the actual level of quotas, we find enormous differences. It is obvious that there is no problem in this respect with the Bretton Woods formula. The heavy use of borrowing made by the Fund in recent times, however, indicates that the Fund does require the resources and that the problem has been with the excessively low quota increases approved in the several reviews which have occurred up to now.
>
> The primary source of resources for the Fund has to be quotas, which implies that we have to correct the present situation and introduce a sizable adjustment to quotas.
>
> The Fund has not previously had a level of credit outstanding as high as the one reached in the last two years. Behind that increase in credit outstanding is the problem faced by many members suffering from unfavorable external circumstances. The calculated quotas presented by the staff would tend to lead to a reduction in the share in total quotas for those members that have suffered the most from these external circumstances and excess indebtedness, and in general for the countries that have made heavier use of Fund resources in recent years.
>
> This seems to us to be an awkward situation. The Fund's role is to prevent problems in the international financial system and to facilitate adjustment undertaken by specific countries. The level and distribution of quotas should serve that purpose. The reduction of the share in total quotas of the countries with the more protracted problems, and among them, the indebted developing countries, would run contrary to that purpose, and would limit the Fund in performing its role.
>
> In part, the problem might be that the formulas we use have failed to consider appropriately the specific variables explaining the recent need for Fund resources in some member countries, like indebtedness or the variability of current payments. If

the origin of the problems affecting member countries in recent years was not predictable as a source of difficulties in past quota reviews, we should consider incorporating them now in our formulas.

Also, our formulas might be giving excessive weight to variables like GDP or international reserves at a given moment in time in circumstances that might coincide with the lowest point in a process of adjustment and, therefore, might not lead to an appropriate representation of the countries' situation.

I leave it to the staff to comment on these points and perhaps to propose new formulas that will result in adequate quotas for countries needing them the most so that the Fund can perform its role adequately.

We will support an increase in quotas but before discussing concrete schemes, we would like the staff to look at the existing formulas to see whether they have been able to capture the precise determinants of demand for Fund resources. We would like to have staff views on how to incorporate variables that embody the sources of balance of payments difficulties and the demand for Fund resources that are behind the recent strong increase in the utilization of Fund resources and that presumably will still be there for some time.

Mr. Rye made the following statement:

I am reminded of the remark made by an Executive Director on the occasion of the last quota review, to the effect that the only statement he could make that he was sure would not be contested by one of his colleagues was that this is a very difficult issue. It certainly is. I am sorry to say that I do not think it has been made easier by the presentation first up of a paper which plunges us immediately into "nuts and bolts" issues. I hasten to say that this is not a criticism of the paper itself, which seems to me to be a very professional piece of work. But like some other Directors, I would have expected us to begin our work with some kind of overview paper that addressed such issues as the role of quotas in the Fund, and the case for an increase.

At any rate, taking the paper before us at its face value, a number of issues arise. First, I note that some--perhaps many--Directors have derived from Table 3 the proposition that the Ninth Review of Quotas should result in a substantial increase. While I can see the prima facie case, I think it would be premature to jump to conclusions ahead of the further staff paper which is promised on that subject.

Second, there is the question how far to reconcile actual with calculated quotas. Here again I am not yet ready to reach a final judgment. Certainly, the arguments for reducing the disparities carry some weight. On the other hand, I have been impressed by Appendix VI, which ranks present quotas and calculated quotas side by side in descending order. As we run the ruler down this table, we see that the calculated quotas are larger in the first seven positions, the ninth, and the 21st to the 34th, a total of 22 only. In all other cases--127 of them--the present quota is larger than the corresponding ranked calculated quota. This means that a large move toward calculated quotas would concentrate the bulk of quotas in fewer and fewer hands.

Of course, this may simply reflect the reality that, in relative terms, capacity to subscribe to quota increases is for most countries diminishing. But quotas are also the key which unlocks access to the resources of the Fund.

The implications of this table leave me with an uneasy feeling, and incline me rather toward the conclusion that any move to reduce disparities between actual and calculated quotas should be spread over a number of quota reviews--and in the Ninth Quota Review should be fairly modest. If that were to be the ultimate outcome, the question would arise whether special increases would need to be available to those members whose actual quotas fell particularly far short of their calculated ones.

Third, there are the detailed points about the formulas that have been raised. While none of my constituency countries have raised any particular problems with the compromise formulas decided upon for the Eighth Quota Review, I must say that I think they do lead to some quite anomalous results (the most cursory examination of Table 9, for example, would certainly lead one to that conclusion). Accordingly, I am not yet ready to embrace the staff view that we should stick with the formulas used last time, although if there had been sufficient consensus in the Board that we should do so, I would not have stood aside. But that does not seem to be the case.

On particularities, I share the concerns of those who have questioned the use of variability. It is obvious that this element of the formula is meant to relate to need; and in that context it seems to me highly anomalous that the chief beneficiaries are those members whose reserves have fluctuated between extraordinarily large and merely very large. I would join Mr. Wijnholds in asking the staff to investigate whether some means cannot be found to confine the benefits of variability to those countries to which the need criterion clearly applies.

On data questions, I agree with the staff that the relatively large amount of staff estimation of the data used in making quota calculations is a cause for some concern. It certainly argues against bringing the calculations any more up to date than 1985--unless, of course, our deliberations on this matter drag on and on, when the question of updating will certainly acquire greater urgency. In this regard, however, I have a good deal of sympathy for those who have questioned the use of data for a single year. Given the extreme fluctuations in such key relationships as exchange rates, there would certainly now seem to be a strong case for using, say, a five-year spread of data.

Further, like Mr. Yamazaki, I am not altogether happy with the rather cavalier treatment of the gold component of ECUs. I would like to see the calculations that lead the staff to conclude that a revaluation of the gold deposited with the European Monetary Cooperation Fund (EMCF) to SDR 35 would "have little impact on the calculated quotas."

Finally, there is the question of the very small member countries. Most of these have highly open economies and the quota calculations result in potential drawing rights which are very small in relation to the size of their external transactions. I join with Mr. Massé in asking the staff to see whether any device can be found to provide some protection for these members.

Mr. Santos made the following statement:

Like other Directors, we see this discussion as the first step of a process that is expected to be a lengthy one as shown by the experience of past quota reviews. On the other hand, we would favor a simultaneous discussion with the forthcoming paper on the size of the Fund. Therefore, our comments will be rather brief and of a general and preliminary nature. Also, it is not our intention to elaborate on the statistical and computational merits of the paper under consideration today. However, the staff has done comprehensive work in this field, some aspects of which deserve our attention.

There is, first of all, the recognition that any set of formulas is far from perfect and will remain controversial. A degree of continuity given by the formula basis in the review process is desirable and at the same time provides the starting point and reference lines for further negotiations, which of course must take into account considerations of a diverse nature. Second, we share the staff's concerns on the extensive use of estimations of relevant variables in the quota calculations. As the statistical apparatus in a large number of countries in our constituency is weak, it is understandable that our authorities might question the results achieved so far and, therefore, the reliability of the calculated figures. Third, as other Directors have already pointed out, adverse developments in the period under review have coincided to further damage the relative position of developing countries in the computational picture provided by the staff paper (especially that of the sub-Saharan African countries) general fall in commodity prices, prolonged drought, depreciation of exchange rates, initial deflationary impact of adjustment programs, and so on.

To turn to the substantive issues of the quota review, like other speakers, we note that the trend in the agreed quotas under previous reviews has not kept pace with the growth of the world economy. The gap has substantially widened since the Fourth Quota Review. As demonstrated by Table 3 in the staff paper, the ratio of actual to calculated Fund quotas has decreased steadily from 1.04 in 1965 to 0.43 at the completion of the Eighth Quota Review in 1983. While we recognize that it is premature to advocate a certain level of quota increase, a case can indeed be made for a substantial increase in the Fund's capital base under the present quota review, if the role of the Fund as provided by the Articles of Agreement is to be preserved. This increase, in our understanding, could be negotiated as a package that would provide for both equiproportional and selective increases.

At this point, we would like to express our reservations about the proposal that was made at the previous meeting to leave countries in arrears with the Fund out of the distribution of individual quota increases. In our previous discussions on arrears, it was advocated that we should guard against placing this issue in the wrong context. We have difficulties in reconciling this proposal with the spirit of the Articles of Agreement. Apart from the fact that the proposal was linked to the use of Fund resources, in practical terms, if a country is in arrears to the Fund, either it will settle them in the near future or it will be declared ineligible to use Fund resources. In the latter case, the quota increase for the country concerned is irrelevant when it comes to the use of Fund resources. In the former case, it seems unreasonable that the Fund would discriminate against the country in question after it has demonstrated its cooperative stance by settling its financial obligations.

With respect to distributional aspects, both at regional and individual country levels, the results of the statistical work are a cause of much concern to this chair. As we have mentioned before, the relative position of developing countries has weakened. In the case of Africa, and to mention only our own constituency, the tables show that the calculated quota share under the Ninth Quota Review for the 24 countries represents less than 0.7 percent of total quotas against the present 1.4 percent. This 50 percent decrease in the relative quota share of this constituency is disturbing and unacceptable. My authorities are of the view that our present quota share should at least be maintained.

We agree with the views expressed by the majority of the Board that the current review should provide the opportunity for a further correction of quotas of individual countries that are clearly out of line with their relative importance in the world economy. Nevertheless, it is expected that, in order to strengthen the cooperative character of this institution, due consideration should be given to keeping the essential balance between regional groups or, in other words, between developing countries and industrial countries. Particular attention should be given to the relative position of low-income countries, African in their majority, whose relative share is being seriously threatened. In this regard, we endorse the proposal that a "poverty index" be included in the quota formulas as recommended by the Group of Twenty-Four's Report on the Role of the IMF in Adjustment and Growth. Mr. Massé's proposal that a minimum general quota increase be agreed upon for this group of countries has our full support.

Finally, and in line with our previous discussions, we support the suggestion made by some of our colleagues that the increase in quotas be financed through an allocation of SDRs.

Mr. Salehkhou made the following statement:

I welcome this first and preliminary meeting of the Committee of the Whole on the Ninth General Review of Quotas although I cannot help but express a sentiment of uneasiness regarding the purely technical nature of the otherwise excellent paper before us. I took time to review the procedures we followed for the Eighth Review, which I had both the privilege and the agony of participating in. I recall that our first paper was entitled "Work Program"; the second, which followed almost immediately, dealt with the size of the Fund in the 1980s; and the third addressed considerations relating to the continuation of general and selective quota increases. It was not until the fourth paper that quota calculations were presented.

Are we sufficiently far ahead in our work to consider the quota calculations before the Committee has had a chance to establish a work program, express its views and give guidance to the staff? The answer is, of course, in the negative, and the technical nature of the paper reflects a lack of political consensus on a quota increase on the part of some major members of the Fund. I sincerely hope that this lack of political consensus on a quota increase, unlike on the SDR allocation, is only temporary, and that in due course the necessary majority will emerge for a sizable increase in Fund quotas in order to enable the institution to continue to function properly and to play its leading role during the difficult years ahead.

I believe that the strength of the Fund's liquidity position is not a justifiable argument for deferring the decision on the necessity of increasing quotas. As I have mentioned on many previous occasions, this relatively comfortable financial position is rather artificial and has been achieved in light of a deliberate policy of rationing access to Fund resources and of discouraging members from using these resources by an undue hardening of conditionality. Moreover, the recent tendency to focus the activities of the Fund on the countries qualified to use the resources of the structural adjustment facility on the one hand, and on multilateral surveillance for large industrial countries on the other, has put at risk a large number of middle-income countries whose problems might not be receiving the attention they deserve. For those countries, a stable and assured flow of assistance from the Fund could be vital in the coming years.

Indeed, we all know that, despite strong and persistent adjustment efforts on the part of these countries, the external environment remains unfavorable. Commodity prices continue to plunge with no relief in sight, the world economy remains sluggish, protectionism is on the rise, exchange markets remain unstable and volatile, and official as well as private financial flows are sharply reduced and hard to come by. These are only a few of the problems these countries have had and are continuing to face in the foreseeable future.

Confronted with such a situation, more and more countries have difficulties in servicing their external debt, including their obligations to the Fund. If we are to help our membership as we legitimately should, we have to step up our activities in order to make up for the interruption or reduction in other flows and to play our catalytic role.

Unfortunately, this does not appear to be what we have been doing for the past three to four years. The role of the Fund has been reduced as evidenced by the low levels of lending activity demonstrated in the staff paper before us. In this respect, Table 3 shows clearly the steady decline in the ratio of the actual to calculated size of the Fund, based on calculated quotas as well as on the ratio of Fund size to GDP, current payments, reserves, and variability of current receipts. All of these ratios, except the one on the size of the Fund to reserves, have declined by more than 50 percent between 1965 and 1983.

It is my sincere hope that we should be able to at least partially reverse such a trend and that we will make speedy progress on the conclusion of our work. I do not believe that the paper itself raises special issues. I wish nevertheless to stress that:

(1) any new quota increase should not reduce the share of developing countries as a grouping;

(2) some consideration should be given to a better evaluation of macroeconomic variables expressed originally in local currencies; and

(3) although disparities between actual and calculated quotas in terms of the shares of individual members in total actual and calculated quotas were reduced under the Eighth Quota Review, I agree with the staff that large disparities persist. We should in my view try to reduce further such disparities while preserving the principle of uniformity of treatment.

Finally, I am somewhat surprised by the sharp reduction of the calculated quota share of Ghana and the Islamic Republic of Iran and, to a lesser extent, some other members of my constituency between the Eighth and Ninth Quota Reviews. Given the technical nature of these calculations, however, I would be willing to take this issue up on a bilateral basis, should the staff so prefer.

Mr. Ortiz made the following statement:

I look forward to the forthcoming paper on the size of the Fund, but since this is not the subject of today's discussion, I will offer some brief general comments.

First, it is disappointing to observe how the size of the Fund has been steadily declining since the Fourth General Review of quotas undertaken in 1965. By 1983, the ratio of the size of the actual to the calculated Fund based on calculated quotas had been reduced to less than one half the corresponding ratio of 1965. Given the tasks that the Fund has had to perform in the context of the debt strategy, and its future role--which should be clarified in the forthcoming discussion on the role of the Fund in the 1990s--and the well-known fact that other sources of balance of payments finance for the vast majority of developing countries have become increasingly scarce, my authorities consider it important to reverse the above-mentioned trend. I was encouraged to hear several speakers from major industrial countries express their willingness to consider a sizable quota increase, in particular, Mr. Yamazaki.

Second, I agree with those Directors who, like Mr. Grosche, expressed the view that the Fund should rely primarily on quotas as a source of finance.

I turn now to comment on some concrete issues derived from the paper on quota calculations, in the light of the discussion at the previous meeting.

Several speakers expressed a preoccupation with the relatively large amount of staff estimation of the data used in making quota calculations. The staff reports that no official estimates for GDP for 1985 are available for 33 countries--more than 20 percent of our membership. Yet other Directors mentioned that more recent data--especially on GDP and trade flows--should be incorporated in order to capture the rather significant movements in exchange rates that occurred from 1985 to 1986.

I would like to note that there is an obvious trade-off between currentness and completeness that has to be taken into account. It is mostly low-income countries that suffer from a gross underestimation of GDP--as noted by Mr. Abdallah--owing to the limitations of data availability and the fact that large segments of the economy are not incorporated into markets and that are not adequately measured in normal GDP calculations.

If I were to take a pragmatic approach, I would tend to concur 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 of Quotas. Listening to the discussion has, in a way, reinforced this view. As Mr. Lankester noted, formulas are not perfect and they are not supposed to be. They represent a compromise among different positions, and I am sure that each of us can find very good reasons for changing or modifying these formulas.

For instance, it is obvious that with the onset of the debt crisis, most heavily indebted developing countries have experienced a decline in calculated quota shares with respect to those obtained in the Eighth General Review. The reasons are clear: currency depreciation has lowered the SDR value of GDP, and adjustment efforts as well as the lack of finance have depressed the level of trade flows and international reserves. Yet, it is this group of countries which will probably need the greatest access to Fund resources in the forthcoming period; thus it would seem odd to reduce quotas in relative terms in this group of countries precisely when the need will be greatest. One way of taking these facts into account is to include some measures of absolute and relative indebtedness in quota formulas. We should discuss these matters, on which I believe the staff will prepare a paper. However, such measures must be combined with a more pragmatic approach, and I believe that quota formulas are a reasonable compromise.

Finally, regarding the gap between calculated and actual quotas, we are of the view that this gap should continue to be reduced, but that care should also be taken to ensure that countries with small calculated quotas, which are greatly exceeded by actual quotas, are not hurt excessively in the process.

The Deputy Treasurer noted that the timing and thus the structure of the Eighth General Quota Review was different from that envisaged for the Ninth Review. There had been a specific request to the Executive Board by the Board of Governors, carried over from the Seventh Review, to review the customary method of calculating quotas. Even before the Committee of the Whole had been established, a first staff paper on the economic criteria entering quota calculations had been issued, on February 13, 1981, for consideration by the Executive Directors at an Executive Board meeting (EBM/81/29, 2/27/81; and EBM/81/30, 2/27/81). A series of papers had been built on that first paper and considerable discussions had taken place ahead of the stage at which it had been considered appropriate to issue a quota calculations paper, the stage reached currently by the Committee of the Whole. Traditionally, the quota calculations paper had been the first, accompanied at times by a paper on the size of the Fund, but not necessarily always. The dimensions of the Eighth Review had also perhaps led the staff to try not to repeat some of the preliminary work that had been done at that time. As Directors would recall, the Eighth Review had taken two years, from February 1981 to February 1983; Directors had spent almost 100 hours in discussion; it had been very extensive, with 52 staff papers, 43 of them on technical issues, having been circulated; and 1 million simulations had been done through the computer--with over 250,000 calculations presented to the Committee.

The quota formulas had been reviewed fairly frequently, the Deputy Treasurer noted. During the Fourth Review in 1962-63, the basic structure of the formulas that were still being used had been agreed. Following another examination at the time of the Sixth Review in 1973-74, it had been decided to make no changes in the formulas. The major review of the formulas as part of the Eighth Review had in fact covered all the topics that had been raised by Directors during the present discussion. To recapitulate, at the time of the preceding quota review, there had been a proposal to average GDP over five years; another proposal had been to use purchasing power parity prices for conversion rather than the current exchange rates. The cyclical variation in the timing of the quota data had raised the issue of the disadvantages to some countries and advantages to others; for instance, the United States had taken the position that using the exchange rate for 1980 seriously disadvantaged the United States. The point had been made during the present discussion that some countries, with the recovery of the exchange rate of the U.S. dollar to its 1985 position, were disadvantaged by the use of 1985 data.

The question of the valuation of gold had been extensively discussed during the Eighth Review as well, the Deputy Treasurer recalled. The Executive Board had decided in 1979 that all Fund operations and data involving Fund operations in gold should be valued at SDR 35 per fine ounce, the only price at which the Fund could sell gold officially. As Executive Directors had again noted, the ECU was an anomaly in that respect, but the staff had felt justified in keeping in reserves the ECU "counterpart" of the gold and U.S. dollars deposited with the EMCF because the conversion of the gold gave rise to an asset that was usable in balance of payments financing. The fact that gold was valued at a premium price did not preclude the use of the ECUs under the settlement provisions of the European Monetary System.

The issue of reserve currencies had also been raised during the Eighth Review, the Deputy Treasurer mentioned. Mr. Dallara had taken the matter further by stating that there was no difference between the U.S. dollar and other reserve currencies, and some sort of accommodation should thus be made in the quota formula of the status of reserve currencies. The staff view was that if there was a special reserve currency status, it did not apply to a group of currencies; the link with the operational budget that Mr. Dallara had made was different for the U.S. dollar than for the currencies of several other Fund members that had reserve currency status. Those currencies were converted into U.S. dollars in about 85 percent of the Fund's operations, whereas the U.S. dollar was rarely, if ever, converted when the Fund sold it in operations. The U.S. dollar therefore had a rather unique status in its ability to bear and finance a reserve tranche position that other reserve currencies did not have.

Bringing a financial variable into the quota formulas, another matter raised by Mr. Dallara, had also been discussed in 1981, the Deputy Treasurer commented. The outcome of the discussion had been that the long-term capital account was basically reflected, with a time lag, in the current account. Short-term capital movements were of course reflected in the reserve positions--either the net or gross reserve positions--and they were captured in the quota formulas of the time. The use of current payments, rather than of current payments and receipts, had also been considered in the previous quota exercise. The possibility of using the higher of the payments or receipts or a combination of the two had been explored. After many calculations, it had not seemed to make any difference in the final outcome, but the staff would reconsider that particular issue. Likewise, the staff had looked at the use of the current account balance and had come to the conclusion, with which the Executive Board had agreed, that it was not a real indicator of an economy's size or of a country's financing need. That issue too would be reconsidered.

Variability had been the subject of a major discussion during the Eighth Quota Review, the Deputy Treasurer commented, because it had led to a marked increase in the calculated quota position of some countries.

The greater importance attached to variability in the current quota review had a different origin. In the Eighth Review, the variability calculations reflected two large discrete jumps in oil prices, namely, the 1973/74 and the 1979 increases. The debate that had ensued ranged from suggestions to eliminate variability altogether to changing the definition or reducing the coefficient. In the current review, the 1973/74 increase in oil export prices had disappeared from the calculations, and the importance attaching to variability, which would work as it should, derived from the subsequent fall in oil export proceeds in the 1980s. The methodology was analogous with the way in which the decision on the compensatory financing of export fluctuations operated. Furthermore, the ups and downs in the oil export price had ramifications throughout the economies that were highly dependent on oil. The effect was felt both on reserves and GDP, as well as on the total volume of exports, and the rise in variability was not necessarily additional to, but rather compensated for the other variables that had fallen. In the case of oil, variability was working as it had originally been devised to work, perhaps for the first time in 15 years.

The issue of the poverty index had also been discussed during the Eighth Quota Review, as well as in 1971/72, the Deputy Treasurer recalled. Introducing such an index into the formula would involve complications, because of the possible negative sign, but the staff would look at the issue again. In sum, a dozen of the points that had been raised with respect to the variables were not new to the staff, which would on the present occasion again give them due consideration.

On the points made with respect to members' arrears, the Deputy Treasurer mentioned that in its six-monthly report on overdue obligations, the staff had promised to take up the issue of arrears and quota increases separately. It should be noted, however, that the calculations in EB/CQuota/87/1 covered the Fund membership as a whole, with the single exception of Kampuchea, for which no data were available on which to make any calculations. The staff had also indicated that it would return later in the quota review to the issue of arrears, in particular because that aspect might well become more important at a later rather than an earlier stage. One way of looking at the issue, but not the only one, would be to take it up as a matter of payment, in line with the nature of the quota increase, rather than as a matter of arrears. Looked at in that way, the issue of arrears would become one of whether quota payments should take precedence over the discharge of overdue obligations to the Fund.

The situation of small countries would have to be taken up in due course and indeed, the Executive Board had previously been enjoined to do so by the Interim Committee in its communiqué (February 1983), the Deputy Treasurer noted. In fact, one small island economy--Seychelles--had previously indicated its interest in a selective quota adjustment within the context of the Ninth Quota Review. The issue of quotas for small countries might well have to be taken up more broadly.

The staff representative from the Treasurer's Department explained that the background to the treatment of interest on international bank activities was to be found in the revision of the current account balance of payments statistics of a number of OECD countries, which put the figures for those interest flows on a gross basis. In previous quota reviews, the figures had generally been on a net basis or, if not, they had not made a major difference in the calculations. For the Ninth Quota Review, the impact of using data on a gross basis was large and affected significantly the positions of a number of major countries. The staff had explored the matter with the Executive Directors concerned and, with their cooperation, had been able to treat their international interest flows on a net basis.

On the question of variability, the staff representative from the Treasurer's Department recalled that as indicated at the time of the Eighth Quota Review, when a major review of that factor had been undertaken, the role of variability in the quota formulas was to reflect the instability of the member's external sector, irrespective of its balance of payments position. The linkage of the role of variability with the deficit countries was possibly more a matter of coincidence because the change in the definition of variability had taken place when the decision on compensatory financing of export fluctuations was adopted in 1962/63.

Mr. Dallara remarked that it was reassuring to learn from the Deputy Treasurer that the Board was wise enough to recognize many of the same issues that Directors had recognized as warranting consideration during the previous quota review. Nevertheless, he looked forward with interest to reconsideration of the issues that his predecessors had raised.

The thrust of his point concerning the use of the U.S. dollar had not been to suggest that the dollar was necessarily identical with other reserve currencies in its characteristics and use, but to suggest instead that it had certain broad similarities with the deutsche mark and the yen, in particular, as well as with other freely usable currencies in the Fund, Mr. Dallara added. If the Treasurer's Department perceived that the dollar was so unique that it deserved singular special treatment, he would not press the point, which had in fact been made in a spirit of generosity. For example, the use of every other currency included in the operational budget was generally guided by the ratio of a member's reserve tranche position over its gold and foreign exchange holdings, and the relative ratios among the members whose currencies, along with that of the United States, were used in the operational budget. But the staff had stated clearly in a variety of reports that the gold and foreign exchange holdings of the United States were not "an adequate measure of the ability of the United States to finance a reserve tranche position in the Fund." If the special nature of the U.S. dollar was recognized on a regular basis in that case, it seemed valid to raise the question of whether or not U.S. gold and foreign exchange holdings should be treated in the same way as those of other members when it came to a judgment on the size of its quota, since the ability of the United States to finance Fund operations was not entirely unrelated to the basic purpose of a quota, as well as to the operational budget.

Mr. Sengupta said that, in addition to all the suggestions that the staff would be taking up, it would be helpful to experiment with one or two different methods of transformation of the equations because of the difference in the outcome not only with respect to the numbers but the implications of the particular method used.

On the point that he had raised at the previous meeting on how to give a better reflection of a country's income position in 1985 or 1986, compared with 1979 or 1980, than under the current method of converting the domestic currency measure of income into SDRs, Mr. Sengupta suggested that the staff consider taking a reference year for GNP and a given exchange rate, applying to it the rate of growth of GNP measured in the country's own currency. In other words, the real income growth of the country--or its own particular cost structure--would be reflected in the measurement of GNP; that rate of growth would be applied to GNP for the initial year, converted into an exchange rate, which would be fixed at that particular point. Biases were being introduced into the system in a number of different ways, and the suggestion he had made might be one possible way of experimenting with a different formulation.

Mr. Nimatallah remarked that the reminder by the staff of the number of issues that had been raised during the Eighth Quota Review had encouraged him to say that, if the objective was to conclude the Ninth Review as early as possible, it would be better not to reopen the issue of the components and coefficients of the formulas. Lengthening the debate by taking up such issues was not, moreover, likely to lead to success in changing the structure of the formulas or the coefficients assigned to each variable. As a forewarning of what might happen, he could mention that any such debate would encourage him to ask for an increase in the coefficient of variability.

Continuing, Mr. Nimatallah asked the staff whether it would be possible in some way to devise a method akin to the provision of a certain number of basic votes, to be applied to the determination of quotas, along the lines mentioned by Mr. Massé.

On the question of members in arrears to the Fund, Mr. Nimatallah recalled that although he was among those Directors who advocated preventing certain countries in arrears from obtaining an increase in quota, that did not mean that any country should be excluded from the quota calculations. Whether or not such countries could obtain a quota increase would depend on their standing with the Fund at the very last stage of the process.

Mr. Ortiz inquired whether inclusion of debt statistics had been an issue during the Eighth Quota Review.

The Deputy Treasurer responded that the only impact of the debt situation on the Eighth Quota Review had been to expedite its completion.

In response to Mr. Nimatallah, the Deputy Treasurer recalled that a proposal had been put forward at the time of the Eighth Quota Review to increase the size of the quotas of small island economies by establishing a minimum quota of SDR 25 million. The near doubling in effect of their quotas would have given those small economies 250 votes in addition to the 250 basic votes to which all members were entitled under the Articles. The proposal had not been received well, either by the Executive Board or by the Interim Committee, for two reasons. First, the quotas of small island economies would have become greatly out of line with the size of their economies and of their needs. Second, for many of the countries, a first credit tranche drawing would have been near to the total of their trade, which was not necessarily the appropriate relationship between conditional use of the Fund's resources and financing need.

In response to a question by Mr. Lankester, the Deputy Treasurer recalled that the review of the quota formulas, including the new data and the coefficients, had consumed the first 17 and a large part of the remainder of 38 meetings of the Committee of the Whole, or about 60 percent of the total time devoted to the quota review. There had been no agreement on any one part until general agreement had been reached late in 1982.

The Chairman made the following summing up:

Let me try to sum up this first consideration by the Committee of the Whole on the Ninth General Review of Quotas, which has been most useful, even though the views expressed by many Directors were preliminary. A number of interesting technical issues have been discussed that have important consequences for the policy-related issues which will arise in due course during this review of quotas. Directors have addressed five broad questions--the data used in calculating quotas, the quota formulas, the size of the Fund, the method of allocating quota increases, and the next steps--and I will organize my remarks around these themes.

Data used in making quota calculations

The calculations are made on the basis of data ended in 1985, which is an updating of the material by the normal period of five years since calculations were made in connection with the Eighth General Review. Most Directors agreed that the period through 1985 provides an adequate basis for making quota calculations, although some Directors mentioned the possibility of using data ended in 1986. It would be unusual to use data in excess of five years from the date of the last calculations and the lack of available data would make an updated calculation difficult. We must have a firm statistical base for making quota calculations. As was pointed out, the existing data base for 1985 is not yet, by far, as complete as we would like it to be. While a number of technical questions were raised on the data--for example, the valuation of gold, the averaging of GDP data over a five-year period, and the exchange rate conversion techniques--most Directors agreed in general that the type of data used in the calculations are reasonable. The staff would produce a revised set of calculations later in the year, based on data through 1985, using revised data as they become available and reducing as much as possible the use of estimated data.

Quota formulas

Many Directors were of the view that there were not strong reasons to change the quota formulas that were discussed at length and agreed in connection with the Eighth Review and which the staff has used in making the updated quota calculations. The present formulas resulted from a major review by Directors in 1981-82 of the method of making quota calculations. However, it was understood at the time that appropriate changes in these formulas would not be precluded in connection with future reviews. A number of Directors have now suggested that we again examine the quota formulas and some questions have been raised about the possible addition of new variables. The staff will examine further the issues raised by Directors. I would suggest that we take up this matter of quota formulas and the questions raised regarding the variables used in the calculations in the context of a paper which would outline the discussions and conclusions arrived at by the Executive Board in connection with the Eighth General Review. This paper would be brought to the Board's agenda.

The size of the Fund

The quota calculations indicate the extent to which the calculated quotas and their statistical components have grown since the last set of quota calculations were made. As Directors have noted, the calculations presented in the staff paper reflect a considerable although slower growth in the scale of the world economy in the five-year period to 1985, as compared with earlier periods. Fund quotas are now small in relation to the scale of the world economy and to the variables that enter the quota formulas, such as imports of goods and services. Calculated quotas are now 3.5 times the size of present quotas. While the calculations themselves do not purport to provide a precise indicator of the appropriate increase in the size of the Fund, many Executive Directors noted that the statistical indicators suggest that a significant increase in total quotas would be justified, and is needed to enable the Fund to fulfill its central role in the international monetary system in an environment of continued growth of the world economy. Other Directors, however, did not address themselves specifically to the size of the Fund, which will be considered in a forthcoming paper. I should also note that some Directors expressed concern about the growing overdue financial obligations to the Fund and the possible impact of this development on the Ninth Quota Review.

Disparities in the structure of quotas

Many Directors noted that the individual calculated quotas serve as a guide to examining the disparities between members' positions in the actual quota structure and their relative economic positions. Although such disparities were reduced significantly under the Eighth Review, many members continue to have quotas that are substantially out of line relative to their positions in the world economy, as indicated by the latest quota calculations. Most Directors expressed the view that there was a need for further relative adjustments in quotas under the Ninth Review, but a number of Directors also cautioned that changes in relative positions should not be of an order that upset the balance in the quota structure between different types of economies or in the geographical distribution of quotas.

The method of distributing quota increases adopted on the last occasion attracted some attention. The method had the advantage of allowing all members to participate in increases in quotas that directly reflected their current relative economic positions as indicated by their shares in calculated quotas. The system of distribution was thus uniform across the membership. We will come back to this and related issues bearing on the distribution of an overall increase in quotas.

APPROVED: January 20, 1988