FOR AGENDA

SM/96/80

April 2, 1996

To: Members of the Executive Board

From: The Acting Secretary

Subject: **Eleventh General Review of Quotas - Draft Report to the Interim Committee**

The attached draft report to the Interim Committee on the status of the Eleventh General Review of Quotas is scheduled for discussion on Friday, April 5, 1996.

Mr. Tavlas (ext. 37493) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

Other Distribution:
Department Heads

DRAFT

ICMS/DOC/46/96/__

April , 1996

To: Members and Associates of the Interim Committee

From: The Secretary

Subject: **Report on the Status of the Eleventh General Review of Quotas**

This note relates to Item 3(a) of the provisional agenda for the Interim Committee meeting scheduled for April 22, 1996.

In its communiqué issued after the latest meeting of the Interim Committee in October 1995, the Committee "requested the Board to move forward with the Eleventh Quinquennial Review, and to report on progress made at the next meeting of the Committee in April 1996."[1]

The Committee of the Whole on the Eleventh General Review of Quotas has met on four occasions since October 1995, and has considered a number of substantive issues bearing on Fund quotas. In particular, the Executive Directors have considered issues relating to (i) the size of a quota increase, (ii) the distribution of a quota increase, and (iii) basic votes in the Fund's voting structure. The Executive Board has also discussed revised quota calculations on the basis of the same quota formulas used in the Eighth and Ninth General Reviews and using economic data ended in 1993. The attached concluding remarks by the Chairman reflect the discussions by Executive Directors on these issues.

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[1]In connection with the October 1995 meeting of the Interim Committee, the Executive Board reported to the Committee on its discussions on the role of the Fund, the share in Fund quotas of the developing countries, and preliminary quota calculations (see ICMS/Doc/45/95/12, 9/21/95).

The Executive Directors will resume their consideration of the main elements relating to the Eleventh General Review of Quotas in the near future. The progress made so far in their discussions is indicated in the attached set of concluding remarks by the Chairman. The following indicates briefly the main outstanding issues.

1. Quota calculations - The revised quota calculations presented by the staff have been broadly accepted by Directors though certain revisions to the data used in making calculations are being submitted by individual members. In this context, the Directors will also consider alternative approaches to addressing the issue of a few members having relatively fast long-term growth rates and declining shares in calculated quotas which may arise from the conversion of GDP from national currency units into SDR equivalents at market exchange rates.

2. The size of an increase in quotas - The Executive Directors have considered the traditional quantitative factors bearing on the size of an increase in quotas, namely, changes in the scale of the world economy since the last increase in quotas and projections of possible demand for Fund resources through 2002. Directors also discussed the adequacy of Fund quotas in the context of the globalized economy. Directors drew differing conclusions as regards the implications of and the assumptions underlying the quantitative material presented by the staff for the size of an increase in quotas. Many Directors noted that their views on the size of the appropriate increase in quotas are contingent on other aspects bearing on quotas, in particular, the distribution of the quota increase, and the evolution of the Fund's liquidity

position. They expressed concern about the relatively rapid fall in the Fund's liquidity and agreed to monitor carefully the evolution of the Fund's liquidity position. Some Directors also noted that the ongoing discussions on doubling the amount of resources currently available under the General Arrangements to Borrow (GAB) were a relevant consideration in this regard. Furthermore, the Executive Board has clearly stated that the desirable early decision on this matter cannot be seen in any way as a substitute for a proper quota increase.

3. Distribution of a quota increase - Most Directors are of the view that the choice of method to distribute the selective element of an increase in quotas depends on (i) the size of the overall increase and (ii) the size of the equiproportional element. Some Directors also considered it appropriate to provide for ad hoc quota adjustments for those members whose current quotas are significantly out-of-line with their relative positions in the world economy.

4. Basic votes - In view of the sharp decline in the relative importance of basic votes in the Fund's voting structure, many Directors felt that it may be appropriate to revise the number of basic votes for each member--which would need an amendment of the Articles--and could revisit the issue in the event that other amendments to the Articles were to be considered. Directors were of the view that this issue should not slow down consideration of other aspects of the quota review.

Attachments

December 18, 1995

Concluding Remarks by the Chairman
Eleventh General Review of Quotas -
Distribution of Quota Increase - Illustrative Calculations
Committee of the Whole on Review of Quotas Meeting 95/2
December 5, 1995

I believe we have started a process of clarification, but only that, on the issue of the techniques to be considered in distributing an increase in quotas. Further detailed consideration of distribution techniques will be needed as we progress in our discussions, which will also include the overall size of the quota increase and, as several have noted, the issue of basic votes in the Fund. Some Directors were of the view that the question of distribution could be addressed independently of the issue of size, especially as they felt that it would be premature at the present stage to consider the issue of the overall increase in the size of the Fund. Most other Directors felt that the illustrative range of overall increases in quotas presented by the staff was in line with our preliminary discussions on this matter last July and again in August. Many Directors observed that the issue of distribution depends to a considerable extent on the issue of size, because we have to ensure the general adequacy of quotas for all members, and a large selective element in the context of a small overall increase could result in inadequate quotas for some members. The issue of distribution and size is also linked to the distribution of voting power and balanced representation in the Fund. We will be addressing the issue of the size of the overall increase at the next meeting of this Committee in early January 1996.

The issue of the size of the increase apart, many Directors, especially from developing countries, felt that the techniques of adjustment illustrated in the staff paper resulted in an unacceptable fall in the shares of quotas and voting power of their particular countries, while some Directors were of the view that the staff's illustrative methods did not go far enough in increasing the quota shares for those countries whose present quotas are significantly out of line with their relative economic positions. As Directors observed, achieving the right balance between these two positions will be an important part of our considerations in the Eleventh General Review of Quotas.

Many Directors felt that the amount of the quota increase to be devoted to the selective element, set in the range of 10 percent to 25 percent of the overall increase, was a reasonable starting point. A number of Directors felt that all the illustrative calculations should have been made on the same basis, rather than varying the apportionment of the overall increase as between the equiproportional and selective elements. The staff will issue a set of calculations showing the application of Method B for an apportionment of equiproportional and selective increases of 75-25. However, a number of Directors felt that to allocate an overall increase in quotas in the proportion of 75-25 did not seem to be in accord with the view that the overall increase should be "predominantly equiproportional." Of course, there is room for further consideration of a selective element of between 10 percent and 25 percent of the overall increase in quotas. I should also note that several Directors have suggested that the selective element could be as much as 40 to 60 percent of the overall increase.

Some Directors prefer, or are willing to consider, the approach of making ad hoc quota increases for the members whose present quota shares are the farthest out of line, and who are prepared to contribute substantially to improving the Fund's liquidity. All others would then receive an equiproportional increase, unless the ad hoc approach were considered in combination with a uniform method to distribute selective increases.

Many Directors also commented on the staff's case-by-case treatment of the few anomaly cases that we discussed in July of this year, when it was felt that a few countries' relatively fast economic growth rates had been masked by the use of market exchange rates to convert local GDP data into SDR equivalents. It was noted that the staff's adjustments were helpful in addressing the anomalies in the calculation of quotas for the members concerned, and it was observed that the adjustments did not affect the distribution of increases in quotas--unless Method A was used. A few Directors noted that the GDP for their countries was underestimated because the size of the nonmonetized sector had not been taken into account. However, some Directors were not convinced that there was a particular need for such adjustments to the data used in determining the calculated quotas of these members; and the adjustments could affect the calculations for other countries' quotas and create unwarranted precedents. It is too early to draw the sense of the Committee on this matter.

All in all, today's discussion has shown that most Directors favor a predominantly equiproportional increase, but there remain considerable differences of view on the share of selective increases in the total as well as on the distribution method. Clearly, we need to pursue both Method A and Method B, as well as the matter of the cutoff ratio; while there was little support for Method D in today's discussion, this method also remains on the table. The approach of ad hoc increases also needs to be further pursued, and, finally, a number of you have expressed support for a possible increase in basic votes. The staff will circulate new illustrative calculations on the various distribution techniques after the Committee has considered the factors bearing on the overall size of the quota increase.

BUFF/96/9

February 5, 1996

Concluding Remarks by the Chairman
Eleventh General Review of Quotas - Size of the
Overall Increase in Quotas - Quantitative Factors
Committee of the Whole on Review of Quotas Meeting 96/1
January 31, 1996

This meeting has been very useful in our search for a consensus on the main outstanding issues related to the overall increase in quotas under the Eleventh General Review of Quotas. Considerable differences remain, of course, on the appropriate size of the overall increase, and the views expressed for the current discussion are contingent on other aspects of the quota increase, in particular its distribution and the prospective demand for Fund resources as well as the agreed need for the Fund to maintain a strong liquidity position.

Directors commented extensively on the staff's attempt to quantify some of the main elements bearing on the size of the Fund. Many Directors emphasized the need to keep Fund quotas in line with the growth of the world economy and to take into account the scale of payments imbalances. In this regard, the large majority of Directors agreed that increasing the size of the Fund at least in line with the growth of the world economy would tend to ensure that the Fund would have the resources needed to carry out its role in the international monetary system. As the calculations show, to restore the size of the Fund to the level prevailing in 1983, an increase in quotas of the order of 70 percent would be required. Taking into account the time needed for an increase in quotas to come into effect, the staff observed that it would be reasonable to make a further adjustment in the size of the increase, thereby justifying an increase of the order of 90 percent.

Many Directors have emphasized that the issue of how to equip the Fund adequately in the context of the globalized economy and universal Fund membership was at the heart of our discussion on quotas. They noted that part of the increase in quotas, perhaps a substantial part, should be regarded as precautionary, which would deal with unexpected developments, as is now indicated in a number of the Fund's present policies regarding the use of its resources. Many Directors, therefore, endorsed a doubling of the size of the Fund under the Eleventh Review.

That view was not shared by many other Directors who felt that a smaller but, nevertheless, substantial increase in quotas of the order of 50 percent, 60 percent, 70 percent, 80 percent, or more would be appropriate. Three Directors did not give their quantified view on the overall increase in quotas; one of them was in favor of a modest (but significant) increase. One Director felt it was premature to indicate whether or when an increase in the size of the Fund would be needed.

In today's discussion, there was no dissent from the position that the Fund has an active role to play as the central monetary institution in the international monetary system. However, many speakers put particular emphasis on the increasingly efficient operation of the international capital markets, which would provide creditworthy borrowers with appropriate amounts of finance. If a loss of market access arose, owing to lapses in economic policy, the amount of financing that would need to be provided by the Fund should be of an order that would encourage members to take early measures to adjust.

Directors also considered the potential demand for Fund resources over the medium term as a factor that was relevant to the size of the quota increase. They discussed the staff's attempt at estimating the demand for Fund resources through 2002 based on differing scenarios of the evolution of the world economy. While some Directors regarded these projections as reasonable, others felt that the staff estimates of potential demand were too high and gave too much weight to a worst-case scenario. A number of Directors noted that effective surveillance and the process of graduation from Fund financing on the part of a rising number of countries should--as emphasized today--tend to reduce the prospective demand for Fund resources. Directors, of course, also took into account that the enhanced structural adjustment facility could be used to assist most of the poorer Fund members. Of course, any assessment of potential demand for Fund resources must involve a substantial element of judgment.

A number of Directors referred to the "allowance factor" that the staff developed in its analysis, and several speakers raised questions related to this matter, which the staff has carefully noted for its further work.

A number of Directors have referred to the issue of the Fund being able to borrow in the event of a crisis situation and/or a sharp weakening of its liquidity position. I agree completely that this is an important issue and the ongoing discussions on enlarging the Fund's borrowing arrangements are very welcome. However, there is no dissent from the view that, in normal situations, the Fund should be in a position to rely on its own resources to finance its operations.

Our next discussions on quotas will be in February, when we will take up revised quota calculations and the issue of basic votes. I would suggest, after those discussions, that the staff prepare a short paper for the Committee's consideration in March, which will consider various techniques that could be used to distribute quota increases, taking into account our discussion in December 1995, assuming a range for the size of the overall increase based on today's discussion and the suggestions put forward by Directors for further work. The paper would also summarize the distribution of voting power, taking into account the outcome of our discussion of basic votes.

BUFF/96/23

March 8, 1996

Concluding Remarks by the Chairman
Eleventh General Review of Quotas - Issues Relating to Revised Quota Calculations and the Size of Basic Votes
Committee of the Whole on Review of Quotas Meeting 96/2
February 28, 1996

I. As regards the paper on the revised quota calculations, the revision to the preliminary data used last August were relatively small, and Directors noted that the revised data primarily reflected members' official data rather than staff estimates. The extent of estimation of data had now been reduced to almost negligible proportions. Most Directors agreed to consider the revised calculations as essentially final for the present review, although several Directors encouraged the staff to update the calculations as the review proceeded. I would, however, suggest that unless the revisions were of a material nature, we should regard the calculations in the paper discussed today as essentially final, except for those five countries that have not yet submitted data. Also, a few Executive Directors noted that they were awaiting final confirmation of the data for some of their countries.

A number of Directors commented on the issue of conversion of GDP into SDR equivalents using real effective exchange rates, and the adjustments made for a few countries to use, as the calculated quota, the highest of the five results of the quota formulas. Some Directors were not convinced about the need for using the real effective exchange rate to convert GDP data. Those Directors noted that the problem stemming from a very sharp depreciation of an exchange rate would work itself out over the medium to long term, and that the member's growth rate, in terms of its SDR equivalent, would eventually be reflected in the customary quota calculations. They also emphasized the importance of evenhandedness, and a broad-based approach to quota calculations, but would be ready to consider alternative approaches that would address the problem for those countries.

Other Directors felt that the techniques used by the staff, while not perfect, were reasonable approaches to the problem of reflecting members' real growth rates in the quota calculations for the Eleventh Review. In view of the different views expressed on that issue, I would suggest that we do not conclude on the matter, and that the staff will give further consideration to the issue.

II. Directors generally welcomed the opportunity to discuss the issue of basic votes. As was widely noted, the importance of basic votes in the Fund's voting structure was now extremely small, at about 3 percent of total voting power. Future increases in quotas would reduce the importance of basic votes to virtual insignificance. Directors considered the issue along two important avenues.

First, whether the voting structure in the Fund should increasingly reflect members' contributions to the Fund's resources in terms of quotas; or whether weight should be given to the importance of individual members irrespective of economic size, as under the original Articles, and as reflected in the constitutions of some of the regional development banks. While it was noted that there was no provision in the Articles of Agreement to continually adjust the number of basic votes, many Directors felt that the Fund should raise the relative importance of basic votes, and that more weight should be given to individual members in the overall voting structure of the Fund.

Second, many Directors felt that increasing the basic votes would be an important means to help check the relative decline in the voting share of, in particular, the smaller and mostly developing countries in the Fund. A number of Directors felt that the issue of basic votes was not a high priority, and that the position of the developing countries should be protected more by appropriate increases in their quota shares. In that regard, they noted that the Fund has already taken other measures to ensure appropriate quota shares for the smallest members.

The discussion on basic votes was not final. The issue was likely to resurface, for instance, when discussions on the size and distribution of the quota increase were further advanced. Furthermore, a number of Directors felt that an amendment of the Articles, solely for the purpose of changing the current system of basic votes, did not appear to be a practical proposition. Some Directors also expressed concern that that might unduly complicate the speedy completion of the Eleventh Review. Nevertheless, they were prepared to consider a change in the present basic votes structure, in the event that other amendments to the Articles of Agreement were also considered. We should, therefore, keep the issue of basic votes in mind, and return to it at a later occasion if that seemed opportune.

BUFF/96/28

March 15, 1996

Concluding Remarks by the Chairman
Eleventh General Review of Quotas - Further Considerations
Bearing on the Size and Distribution of an Overall Increase in Quotas
Committee of the Whole on Review of Quotas Meeting 96/3
March 8, 1996

We had a useful follow-up to our previous discussions on factors bearing on the size and distribution of an increase in quotas under the Eleventh General Review; and we made some limited progress that we will reflect in reporting to the Interim Committee.

On the size of the quota increase, many Directors commented on the methodology followed by the staff in assessing the demand for Fund resources on a country-by-country basis not only for 1996 and 1997, based on data compiled for the new liquidity exercise that the Executive Board would consider next month, but also for the longer period through 2002. The latter projections were based on particular assumptions and, as the staff pointed out, the assumptions themselves, as well as the list of countries that would seem likely to use the Fund's resources, were subject to a considerable margin of error.

Most Directors noted that it may be reasonable to expect that a number of users of Fund resources in 1996 and 1997 would continue to have a need for Fund resources in the period from 1998 onward. However, the demand from that group of countries was not projected to accelerate, and the net expansion of Fund credit for them was projected to be relatively small. Directors noted that no exceptional use of the Fund's resources was projected during that period, and that on average less than two thirds of absolute access would be used through end-2002. It was also noted that the projections did not include use of the Fund's resources by any major industrial country. Furthermore, for those countries not at present using the Fund's resources, there were a number of countries with large and sustained current account deficits. For those countries, the staff had assumed that 40 percent of the current amount of absolute access would be used by a relatively small number of countries.

Other Directors continued to feel that the staff overestimated the future demand for Fund resources, particularly in the period after 1997, and that, because of the methodology underlying the estimates, the data would suggest that the projected demand seemed to lean toward potentialities rather than likelihoods. Moreover, those Directors took the view that the staff may have overestimated potential use of reserve tranche positions by members in the operational budget; however, the potential use of reserve tranche positions could seriously impact on the Fund's liquidity position.

Three points were drawn from the exercise, and from our discussion of the matter in January. First, the projected fall in the Fund's liquidity over the next two years--for which projections were relatively firm--was substantial, and that had a direct bearing on the timing of the conclusion of the Eleventh Review. Second, the projected sharp fall in the Fund's liquidity through 1997 and early 1998 highlighted the issue of Fund borrowing. As indicated above, the staff had not assumed exceptional use of the Fund's resources and, consequently, it may be reasonable to assume that the Fund would not need to call on the General Arrangements to Borrow to supplement its resources, as the conditions for activation may not be met. In those circumstances, it was clear that we could not accommodate demand for the Fund's resources without borrowing if the conclusion of the review was delayed. Third, those projections again point to the need for a substantial increase in Fund quotas to carry us through 2002.

With regard to the size of the overall increase, Directors generally confirmed the positions they had taken during our discussion of January 31, and I will not repeat here my summary of those positions, which were reflected in the last paragraph of the first page of my concluding remarks for the Committee of the Whole on the Eleventh General Review of Quotas, Meeting 96/1.

Some Directors indicated that they could not come to a firm conclusion on the most appropriate method of distributing an increase in quotas until we advanced further in our discussions on the size of the increase, and on what proportion of the overall quota increase should be distributed equiproportionally. At the same time, many Directors stressed that a relatively large proportion--perhaps as high as 65-75 percent or even up to 100 percent--of the overall increase should be allocated equiproportionally, both to ensure an adequate increase in quotas for each member, and to help stabilize the quota share of developing countries in the Fund. A number of other Directors felt that such a large equiproportional element would not be beneficial to the Fund's liquidity position over the medium term, and would be contrary to the widely accepted principle that members' positions in the world economy should be properly reflected in Fund quotas.

Of the various illustrative methods considered by Directors, the use of Method A and/or B attracted the greatest support. Most Directors supported Method A, the method followed in the Eighth and Ninth Reviews, that is familiar, transparent, and simple, and that may facilitate a more rapid consensus in the quota review. Furthermore, the shift in shares among groups of countries could be limited by reducing the amount of the overall increase devoted to the selective element. Other Directors, however, said that they could support Method A only if the portion of the overall quota increase devoted to the selective element could be maximized to achieve a larger adjustment coefficient.

Under Method B, 40 countries whose shares in calculated quotas exceeded their shares in actual quotas would receive selective increases. A number of Directors argued that the cut-off ratio should be higher than 1.0, for example, 1.3 or 1.5. Some Directors were also in favor of considering a very few special or 'ad hoc' quota increases for countries in that group combined, perhaps, with a relatively large equiproportional element in the overall increase.

Some Directors were attracted to Method E, which was conceptually a substitute for Method B but provided for symmetrical adjustments. Those Directors favored Method E provided that the restructuring of quota shares thereby achieved would be significant. Many Directors, however, noted that Method E could result in a substantial decline in the quota shares of many developing countries. It was clear that Method D, which was a close variant of Method A, could be dropped from further consideration. Therefore, I would suggest that future discussions on the distribution techniques be confined to Methods A, B, and E.

Some Directors raised the issue of the conversion of the GDP data used in the quota formulas that applied to eight countries identified in EB/CQuota/96/2 as having had relatively fast long-term growth rates and declining shares in calculated quotas. The staff would prepare a short note on methodological alternatives for possibly dealing with that issue, although I have noted the position of a number of Directors who feel the data should not be adjusted.

As earlier indicated, a report would be made to the Interim Committee in April. That report, which could be brief, could usefully summarize our recent discussions on the various issues that we have considered over the past few months bearing on the size and distribution of the quota increase.