Report of the Executive Board to the Board of Governors

Quota and Voice Reform in the International Monetary Fund

August 31, 2006

I. Introduction

1. **This report reflects the results of the Executive Board's deliberations on the issue of quota and voice reform**. The Board of Governors in January 2003 noted the intention of the Executive Board to consider measures to achieve a distribution of quotas that reflects developments in the world economy and to strengthen the governance of the Fund.[1] The International Monetary and Financial Committee has also reiterated that the Fund's effectiveness and credibility as a cooperative institution must be safeguarded and further enhanced. At its Spring 2006 meeting, the Committee underscored the role an ad hoc increase in quotas would play in improving the distribution of quotas to reflect important changes in the weight and role of countries in the world economy, and agreed on the need for fundamental reforms. This report and the attached Resolution propose a specific package of reforms to be implemented over the next two years.

2. **Executive Board discussions of quota and voice issues over the past year have underscored that governance reforms are essential for the effectiveness and credibility of the Fund.** Members' quotas have become increasingly out of line with their positions in the global economy, and the declining role of basic votes since the Fund was established has weakened the voice of smaller developing countries. High importance has been attached, therefore, to reaching agreement by the Annual Meetings in Singapore on a package of quota and voice reforms. The support for reform in this area across a broad spectrum of the membership indicates that such reforms are not seen as a zero sum game, but rather as change that will strengthen the Fund and from which all members will benefit.

3. **The central objectives of this reform package** are: (i) to make significant progress in realigning quota shares with economic weight in the global economy, and to make quota and voting shares in the Fund more responsive to changes in global economic realities in the future; and (ii) equally important, to enhance the participation and voice for low-income countries, whose weight in the global economy may be small, but for which the Fund plays an important advisory and financing role. The reforms envisaged are intended as an integrated program that should be completed within a two-year period, that is no later than the Annual Meetings in 2008. While the reforms entail significant changes, they are also formulated so as to be measured and respectful of all members.

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[1] Board of Governors' Resolution No. 58-1, effective January 28, 2003 on the conclusion of the Twelfth General Review of Quotas.

II. REALIGNING QUOTAS

4. A number of measures for realigning members' quotas with their relative positions in the world economy are proposed as part of the package.

A. Initial Ad Hoc Increases

5. **The first step in the process of realignment would be ad hoc quota increases for a small group of the most clearly underrepresented countries.** The Executive Board recommends that this group comprise China, Korea, Mexico, and Turkey. These are the only countries that are both substantially underrepresented on the basis of the existing quota formulas and are also underrepresented based on all four variables (GDP, openness, variability, and reserves) broadly considered by the Executive Board as appropriate for inclusion in a new quota formula. These four are also the only countries that are underrepresented based on each of the variables used in the existing quota formulas. Limiting ad hoc increases to this group would ensure that countries included in the first stage meet a robust standard of underrepresentation, while not prejudging the outcome of the discussions in the second round on a new quota formula.

6. **The aggregate size of these first round ad hoc increases should be modest,** given the limited country coverage, and the need to preserve incentives for further more fundamental reforms. At the same time, it is important that the individual increases be large enough to allow for a meaningful reduction in underrepresentedness for the eligible members. In balancing these considerations, the Executive Board proposes that the ad hoc increases should achieve a uniform one-third reduction in the gap between the calculated and actual quota shares (using the existing quota formulas) for each of these members. This would imply proposed new quotas for the four countries as shown in the Annex to the attached Resolution, and would imply an aggregate increase in quotas of SDR 3,808.9 million, or 1.8 percent of total current quotas.

7. **The proposed Resolution provides that the above-mentioned quota increases shall not become effective until the member in question has consented to and paid the full amount of the increase.** Both the written consent and full payment to the Fund for the increase must be made not later than 30 days after the effective date of the Resolution, but the Executive Board would be authorized to extend this period. The Executive Board recommends that 25 percent of the increase would be paid in special drawing rights or usable currencies specified by the Fund with the issuers' concurrence, or in any combination of special drawing rights and such currencies, with the balance to be paid in the member's own currency.

B. New Quota Formula

8. **Agreement on a new quota formula is a key element of the reform package, providing the basis for a further rebalancing of quotas as part of the overall reform program.** There is broad consensus that a new formula should be simpler and more transparent than the existing formulas. The new formula would also need to capture appropriately members' relative positions in the global economy. In this connection,

substantive discussions on a new formula are needed, and it is important not to prejudge the outcome. However, there is considerable support for the view that significantly higher weight should be given to GDP in the new formula. At the same time, other variables, in particular openness of members' economies, should also play an important role, and some have stressed the importance of variability. Given the complexity of the issues involved, the Executive Board intends to start discussion on a new quota formula that can command broad support soon after the Annual Meetings in Singapore. Work on the new formula should be completed before the Annual Meetings in 2007, and no later than the Spring 2008 meeting of the IMFC, to allow time for agreement on a further round of ad hoc quota increases by no later than the Annual Meetings in 2008.

C. Second Round of Ad Hoc Increases

9. **Once a new quota formula has been agreed, a second round of ad hoc quota increases based on the new formula is envisaged,** and is seen as a key part of the reform package**.** This second round should aim to achieve a significant further rebalancing of quota shares, and would be important for further strengthening the Fund's credibility. A broader range of countries could be included in this second round, based on the new formula. Large advanced economies that already have sizable voting power in the Fund and that prove to be eligible for ad hoc increases in the second round may be willing to consider forgoing, or at least limiting, the increases that they request. This would augment the quota increases available for other underrepresented members for a given aggregate increase in quotas. In order to avoid an erosion in voting share of low income countries, these ad hoc increases should not become effective until the amendment in the Articles referred to in paragraph 13 below has entered into force.

D. Achieving Further Quota Rebalancing

10. **Looking beyond the second round of ad hoc increases, it will be important to ensure that quota shares continue to evolve in line with changes in members' positions in the global economy.** Past general quota increases have been distributed mainly in proportion to existing quota shares, with a smaller amount allocated to achieve changes in quota share, for example in the direction implied by members' relative economic weight as reflected in their calculated quota shares (an exception was the Eighth Review, where the selective element was 60 percent of the total increase). As a result, changes in the distribution of quotas have not kept pace with global economic developments.

11. **The Executive Board therefore proposes that the Board of Governors confirm that realigning quotas with members' relative positions in the world economy will be an objective of future quota increases.** Specifically, the proposed Resolution confirms that, in the context of future general reviews of quotas, the Board of Governors will consider distributing any increase in quotas with a view to achieving better alignment of members' quotas with their relative positions in the global economy, while continuing to ensure that the Fund has adequate liquidity to achieve its purposes (the traditional objective of general reviews of quotas). Such a confirmation would serve to send a strong signal of intent on the part of the membership. The Executive Board also plans to consider, as part of the reform

program, whether to amend the Articles so as to clearly specify this objective in the Articles themselves.

III. Voice and Participation for Low-Income Countries

12. **Ensuring adequate voice for low-income countries is a central element of the package.** A key mechanism for achieving this goal is through an increase in basic votes. In addition, steps should be taken to provide extra staffing for the chairs with the largest constituencies, which face particular challenges.

A. Basic Votes

13. **An increase in basic votes, which reflect the principle of equality of states, is the appropriate mechanism to give the smallest members of the Fund, many of which are low income countries, a greater voice in the Fund's deliberations.** This will require an amendment to the Articles of Agreement. While further discussion will be needed on the precise size of the increase, it is envisaged that this will involve at least a doubling in basic votes and will be at least sufficient to preserve the existing voting power of low-income countries as a group.

14. **The Executive Board also proposes that the amendment should include a mechanism for safeguarding the proportion of basic votes in total voting power.** Including a mechanism to maintain a desired ratio between basic votes to total voting power as quotas increase would also avoid the need for further amendments of the Articles each time quotas are increased. Given the time needed for the acceptance of an amendment by members, the Executive Board will seek to put forward a specific proposal by the time of the Annual Meetings in 2007, and no later than the Annual Meetings in 2008.

B. Additional Resources for African Chairs

15. **The offices of the two African Executive Directors face special challenges.** This reflects both the large size of their constituencies and the heavy workload that flows from the important advisory and financing role that the Fund is playing in many of the member countries in their constituencies. Further steps are therefore warranted to strengthen the capacity of African offices.

16. **An immediate step could involve an increase in the staffing entitlement for Senior Advisors appointed by the Executive Directors representing the largest constituencies.** Such a decision should be taken expeditiously, following the Singapore Annual Meetings, based on a specific proposal by the Board's Committee on Administrative Matters. This could significantly enhance the capacity of the two African chairs at senior levels.

17. **As part of the two-year package of reforms, the Executive Board proposes to give consideration to the merits of recommending an amendment of the Articles of Agreement** that could provide that Executive Directors elected by more than a certain threshold of members would have the right to appoint more than one Alternate in order to facilitate the work of their offices. This could further enhance the capacity of African offices,

and would signal the importance the membership attaches to low-income members' effective participation in the governance of the Fund.

18. **It is also noted that management intends to further intensify its dialogue with African Ministers.** Building on already strengthened contacts, the establishment of an African Consultative Group is being discussed with African Governors. This group, which would comprise Fund management, Executive Directors representing Africa, and African Governors, would provide a strengthened channel through which issues of concern to Africa could be raised and recommendations made to management. Management also meets with other formal or informal regional groups to discuss issues of interest to their members as a useful tool to address the different needs of countries.

IV. Other Issues

A. Selection of the Managing Director

19. **There is considerable agreement on the importance of ensuring that procedures for the selection of the Managing Director are open and transparent.** The Executive Board will consider whether further steps, beyond those discussed by the Boards of the Bank and the Fund in 2001 and the steps followed for the selection of the Managing Director in 2004, are needed to ensure a fully transparent process for the selection of the Managing Director, as part of the two-year program of governance reforms.

V. Proposed Resolution of the Board of Governors

20. **In light of the foregoing, it is proposed that the Board of Governors adopt the attached Resolution on Quota and Voice Reform in the International Monetary Fund.** The adoption of the Resolution requires positive responses from Governors having an 85 percent majority of the total voting power.

ATTACHMENT

INTERNATIONAL MONETARY FUND
DRAFT RESOLUTION

Quota and Voice Reform in the International Monetary Fund

WHEREAS, the Executive Board has submitted to the Board of Governors a report entitled "Quota and Voice Reform in the International Monetary Fund" (hereinafter the "Report");

WHEREAS, the Executive Board has recommended a two-year reform program to enhance the credibility and effectiveness of the Fund, as described in the Report; and

WHEREAS, China, Korea, Mexico, and Turkey have requested increases in their quotas to better reflect their positions in the world economy and the Executive Board has recommended increases in the quotas of these members as a first step in the two-year reform program referred to above;

NOW THEREFORE, the Board of Governors hereby RESOLVES that:

1. The quotas of China, Korea, Mexico, and Turkey shall be increased to the amounts shown against their names in the Annex to this Resolution, provided that a member's increase in quota shall not become effective unless the member in question has consented in writing to the increase and has paid to the Fund the full amount of such increase. Each member shall pay 25 percent of its increase either in special drawing rights or in the currencies of other members specified, with their concurrence, by the Fund, or in any combination of special drawing rights and such currencies. The balance of the increase shall be paid by each member in its own currency. Both the written consent and the payment of the increase shall be made not later than 30 days after the date of this Resolution; provided that the Executive Board may extend the period within which the consent and the payment may be made as it may determine.

2. The Executive Board is requested to reach agreement on a new quota formula to guide the assessment of the adequacy of members' quotas in the Fund. Such a formula should provide a simpler and more transparent means of capturing members' relative positions in the world economy. As a means of achieving this objective, consideration should be given to placing significantly higher weight on members' gross domestic product, together with ensuring that other variables, in particular the openness of members' economies, also play an important role. The Executive Board is requested to start discussions on a new quota formula that can command broad support soon after the Annual Meetings in Singapore, and to complete its work before the Annual Meetings in 2007, and not later than by the Spring 2008 meeting of the International Monetary and Financial Committee.

3. The Executive Board is requested, following the completion of its work as provided in paragraph 2 above, to recommend to the Board of Governors by the Annual Meetings in 2007 and no later than by the Annual Meetings of 2008 further increases in the quotas of those members that have requested that their quotas be increased, with a view to achieving a significant further alignment of members' quotas with their relative positions in the world economy, based on the new quota formula; any such increases in quotas shall not become effective until the amendment of the Fund's Articles of Agreement that is requested to be proposed under paragraph 4 has entered into force.

4. As an integral part of the reform program, and together with its recommendation for increases in quotas under paragraph 3, the Executive Board is requested to propose to the Board of Governors an amendment of the Fund's Articles of Agreement that would:
(a) provide for at least a doubling of the "basic" votes that each member possesses pursuant to Article XII, Section 5(a) of the Fund's Articles of Agreement, and thereby at a minimum protect the existing voting share of low income countries as a group and (b) ensure that the ratio of the sum of the "basic" votes of all members to the sum of members' total voting power remains constant following the increase under (a) above in the event of any subsequent changes in the total voting power of members. The Executive Board is requested to put forward a specific proposal by the Annual Meetings in 2007, and no later than the Annual Meetings in 2008.

5. In the context of general reviews of quotas conducted after the completion of the steps identified in paragraphs 2 and 3 above, the Board of Governors will consider distributing any increase in quotas with a view to achieving better alignment of members' quotas with their relative positions in the world economy, while ensuring that the Fund has adequate liquidity to achieve its purposes.

6. The Executive Board is requested to act expeditiously to increase the staffing resources available to those Executive Directors elected by a large number of members whose workload is particularly heavy. The Executive Board is also requested to give consideration to the merits of an amendment of the Articles that would enable each Executive Director elected by a large number of members to appoint more than one Alternate Executive Director.

7. The Managing Director is invited to work closely with the Executive Board in developing the proposals pertaining to the reform package, and to have the staff complete the necessary technical work as expeditiously as possible. The Executive Board is requested to report to the Board of Governors on progress with the reform package by the time of the 2007 Annual Meetings.

ANNEX

	Proposed Quota (In millions of SDRs)
China	8090.1
Korea	2927.3
Mexico	3152.8
Turkey	1191.3