APPENDIX F

Quota Increases at the Fund

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This appendix deals with the negotiation and implementation by India of quota increases at the International Monetary Fund. Quotas represent subscriptions by member countries of the IMF. Payable partly in gold and dollars and partly in the currency of each member, quotas constitute the largest source of the institution's financial resources. They determine a member's voting power at the Fund and the amounts it can draw in need. In the 1960s and 1970s, quotas provided a basis for distributing multilaterally created international liquidity such as special drawing rights (SDRs). However, this appendix is not concerned with international liquidity issues, nor with the terms of access to Fund drawings.

Quotas are determined on the basis of indices such as a country's national income and its share of world trade. Political considerations and alliances also play a significant role. The Fund's Articles require it to carry out five-yearly reviews of the quota structure. A four-fifths majority of voting power is required to effect a change in quotas, and no country's quota can be changed without its consent.

Despite the reservations of its delegates who sought a larger quota, India's quota was fixed at $400 million in 1945. Its was the sixth largest quota after those of USA, Britain, USSR, China, and France. The 'big five' had a right to appoint their own Executive Directors, whereas other Executive Directors at the Fund were elected by country groupings, which tended, for a variety of reasons, to be in a state of some flux. India became one of the 'big five' when the USSR did not join the Fund. But its position in this exclusive club soon came under challenge from West Germany and Japan (whose political rehabilitation in the western alliance complemented their rapid economic growth), and Canada. But thanks to the reluctance of these countries to rock the boat other than gently, widespread recognition of the incongruity of Taiwan (Formosa) exercising the privileges conferred by the large quota unified China was allotted in 1945, and its own efforts, India managed to retain a 'permanent' seat on the Executive Board of the IMF throughout our period.

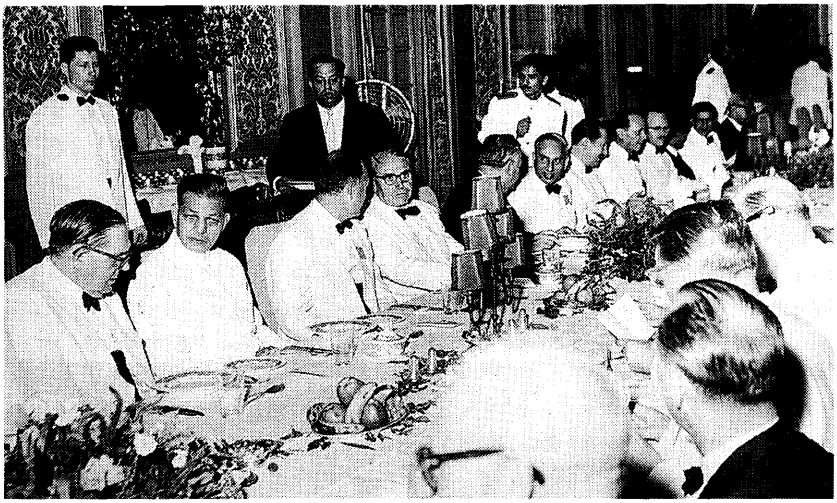
Reviewing Quotas

Far from distributing obligations and powers in any enduring way, the Bretton Woods quota formula quickly became a reference point for revisions. The first exercise to revise quotas was initiated in December 1949 and proved abortive because of the prevailing economic and political uncertainty. The US, which commanded an effective veto because its individual voting strength exceeded the 20 per cent required to block change, was opposed to quota increases in 1951 and 1953, so that it was not until 1955 that an exercise to revise quotas got seriously under way.

Even now there was not much support for a general revision of quotas, nor any great desire to upset existing equations on the Board. The United States and Britain were not willing to add to their quotas, and neither supported West Germany's case for a quota increase which might see it replace India as one of the 'big five'. The US was keener to enhance the position of some Latin American countries and this, principally, led to a suggestion for arranging members into five groups based on their quotas, and increasing quotas such that the smaller quota-holders secured a proportionately larger increase. This proposal gained some support—the quotas of USA, Britain, and China were not to be increased—and for India it had the advantage of blocking a German advance. But consensus proved elusive, and it was resolved in January 1956 that while there would be no general increase, the Board would look favourably upon requests for increases by members with small quotas.

India's seat on the Board being far from secure, several manoeuvres were considered or carried out to safeguard it. One such related to China's position on the Board. The Fund's Managing Director, Ivar Rooth, and several executive directors questioned the appropriateness of allowing Taiwan to sit on the Board and exercise China's large voting power. Aware of Indian anxieties, in 1956 Rooth raised with the Indian Executive Director, P.S. Narayan Prasad, the probability of Germany seeking an increase in its quota, and sought his view on the possibility of India using the China issue as a second line of defence of its position at the Fund. Though this suggestion accorded with India's overall views on China's representation in international bodies, the issue faded into the background for the time being after it became clear that the anticipated German request would not materialize.

Quota revision exercises also carried other risks. One such risk was that they might reinforce the relative under-representation of south-east Asia and west Asia which had, between them, four directors. Europe was over-



Per Jacobsson (extreme left) in conversation with host H.V.R. Iengar, at a banquet for delegates of the Fund–[World]Bank meeting, Delhi, October 1958

represented on the Board since the basic quotas were fixed in 1945 when several countries were still colonies of European powers. Besides, there were anomalies in the constitution of country groupings, some of which also reflected the vestiges of European domination. Indonesia, for example, was represented by Italy, while South Korea was represented by Belgium. The Philippines formed part of the west Asian constellation.

Nor were recent additions to quotas and votes reflected in the Board's composition. Between 1946 and 1956, European votes increased by 8,455 while their elected representation went up by three. Asia's total votes went up over the same period by 8,765, but it had to be satisfied with having only one additional member on the Board. Thanks to a variety of historical and arbitrary arrangements, Europe had annexed seven of the sixteen seats on the Fund's Board. While it was important to increase the Asian representation, it was also necessary to ensure that the new Asian member on the Board would articulate the concerns of underdeveloped countries. These two objectives were not always easily reconcilable. The general policy India followed whenever any Asian or African country wanted to break away from a European-dominated grouping was to assist the formation of more cohesive groups of developing countries which could together send a representative to the Board. Thanks to India's discreet and timely initiatives, in 1958 a new electoral group coalesced around Indonesia after it broke away from its former European group.

The Suez crisis, the wave of speculation against European currencies in the summer of 1957, recession in the US economy, and the sharp fall in prices of primary commodities together increased the demands placed on the Fund's resources, so that by the time the annual Fund-[World]Bank meeting took place in New Delhi in October 1958, there was widespread recognition of the need to revise quotas. With the formal decision to initiate the exercise taken at the meeting, the Executive Board of the Fund met to consider a memorandum suggesting (a) a general increase of 50 per cent in the quotas of all members, with some countries being allowed larger increases, and (b) payment of a quarter of the increased quotas in gold. The latter was judged to be necessary, among other things, to secure US support for enhanced quotas.

These proposals had a special bearing on India's position at the Fund. While a general increase in quotas was welcome, there was the risk that changes in relative quotas might redistribute voting power at the Fund in favour of the industrialized countries, displace India from its fifth position, and cost it the right to appoint an Executive Director. The gold payment obligation would also impose some hardship on India. But the official brief prepared by B.N. Adarkar, the Indian Executive Director at the Fund, and I.G. Patel, his Alternate, to enable the government and the Bank to formulate its views, argued that it was 'unwise' and contrary to India's 'general acceptance of an international approach' to appear to oppose a large increase in the German quota merely in order to safeguard its permanent seat on the Board. An increase in the German, Japanese, and Italian quotas by more than 50 per cent would benefit all countries needing Fund resources, including India. But the present arrangements involved a serious anomaly in that China, which had a quota of $550 million, was represented by Taiwan. If the revision exercise did not lead to an increase in the Chinese quota, India could still be one of the 'big five'. According to the rumour mills, the Americans would probably accept this compromise. Should the latter not be possible, the brief argued, India should strive for an increase in the number of permanent members on the Board from five to six. As it happened, the US was keen to see India retain its permanent seat on the Board, and prevailed on Taiwan not to seek any increase in its overall quota.

Nor would much be gained, the Adarkar-Patel brief argued, by opposing the gold quota. While the need to keep India's gold contribution to the minimum was real and urgent, there were distinct advantages to making it. Besides adding to the Fund's liquidity, India could draw the gold automatically in the event of need. Finally, it was inappropriate to give the impression that all but a few members sought and obtained special exemptions from the responsibilities which went with membership. Recommending a flexible attitude on this question as well, the brief suggested that India could use its sterling balances to buy gold for the contribution.

Along with Egypt, India opposed the gold quota when the Board met several times in November to debate the quota revision. Though various means of easing the burden on developing countries were advanced, it soon became evident that there was no prospect of the gold quota being relaxed. Therefore, Adarkar urged the Governor, H.V.R. Iengar, that India would be acting with 'grace' in accepting 'responsibilities which go with privileges especially when so many other countries not entitled to these privileges had declared their readiness to make the full contribution'. Britain, Adarkar added, was agreeable to India using its sterling balances to buy the gold. Iengar saw the merit in Adarkar's reasoning and concurred in the payment of India's full contribution in gold.

Paying in Gold

The revision, which was shortly approved, meant that India's quota at the Fund would go up from \$400 million to \$600 million. A quarter of the increase (\$50 million or Rs 23.75 crores) had to be paid for in gold, and attention at the Bank turned towards the means of executing this transaction. The Bank advised, and the government agreed, that the 7.9 lakh tolas of gold with the mint and the Reserve Bank (comprising 3.6 lakh tolas of newly mined gold and 4.3 lakh tolas of confiscated gold) valued at \$10 million should be used to make a part of the contribution. The cheapest method of making the remaining contribution of Rs 19 crores was to dip into India's official holdings of the metal. But doing so would reduce them below the statutory currency cover minimum of Rs 115 crores and necessitate an amendment to section 33 of the Reserve Bank of India Act. This was quickly ruled out in favour of using India's sterling balances to buy the metal in the world market.

Thanks largely to India being a member of the sterling area, the Reserve Bank of India had little exposure to the working of the international gold market and no expertise for dealing in it. The Bank therefore decided to act through the Bank of England, which hoped to buy the metal, depending on exchange rates, in London, New York, or Zurich, at a price lower than the US assay price of \$35.08¾ per oz., if it was given some flexibility and discretion in choosing the place of delivery. The Reserve Bank was represented in these transactions by its London manager, V.G. Pendharkar, but to judge from the by-product of 61 cables and 153 letters, they were closely monitored from Bombay.

Transporting the metal too, posed some knotty problems. The Reserve Bank was an authorized depository of the Fund's gold, and there was naturally some preference, subject to cost, for bringing the gold to India. The original proposal was to ship the metal to India on Scindia's boats. But soon fierce competition broke out, and with Air-India offering attractive prices, the contract was split between the two companies. Air-India offered to lift its share of the cargo, ex-London, in nine flights beginning mid-September, while Scindia promised to do so in three bottoms fitted with strongrooms, the first boat leaving in the first week of September. Harrowing tales of train journeys through jungles led the Deputy Governor, K.G. Ambegaokar, to favour lifting the gold from Bombay to Nagpur by air.

The purchase and transport operations did not go off without hitches. The unavailability of wooden containers of a specific type required for packing the gold led to some delays and to the first Scindia boat being missed. Meanwhile, the sterling came under pressure during the last week of August and the first week of September. Anticipating this eventuality, Pendharkar had advised officials in Bombay to buy spot dollars in the summer. But little came of his suggestion, and now in September, Pendharkar advised the Bank of England to defer the gold purchases until the exchanges turned more favourable.

The logistics of transport too, were not easy to work out. The risk of unloading gold in Nagpur after sundown meant the metal having to be held overnight at the Bombay airport. Flights from London to Bombay departed early on some days of the week, and the risks, likewise, of transporting gold through London in the small hours led to the agreed schedule being altered. Purchases recommenced towards the middle of September. Shipments by air began on 29 September 1959 and were completed a month later. Arrangements were also concluded to bring gold worth Rs 9 crores by sea on Scindia's 6,370 ton freighter, M.V. *Marilu*—which though a single screw vessel had a triple-A rating—sailing from the Surrey docks. Every precaution was taken to maintain the secrecy of these arrangements. Despite this, news of gold being loaded for India on the *Marilu* was splashed the same day in the *Evening News* whose report also carried the precise value of the consignment on board the vessel. By 30 October 1959, all the consignments, aggregating 14,28,617 fine ounces, had found their way safely to Nagpur.

Revising Quotas Again

From India's standpoint, the outcome of the 1958–59 review of quotas was quite satisfactory. Although the relative quotas of Canada, Germany, and Japan were also raised, India had managed to retain its fifth position at the Fund. The next quinquennial review fell due in 1965. There was general support for a revision when the subject was raised in 1964. Gold subscriptions were now an accepted part of quota revision arrangements, but apart from the nervousness of developing countries about finding the gold with which to subscribe to their new quotas, the 1964–65 exercise was carried out in the shadow of the deteriorating gold position of the key currency centres. While discussions were simultaneously initiated on multilateral liquidity creation which culminated in the Special Drawing Rights (or SDRs), the more immediate fear of the key currency countries was that higher quotas would lead to the metal being diverted to the Fund from London and New York. The latter problem was resolved, over France's objection, by allowing the Fund's enhanced gold holdings to be held in deposit. The fears of developing countries were sought to be addressed by allowing them to finance their gold subscriptions using special drawings (not to be confused with SDRs, which came into existence in 1969) from the Washington institution.

Preliminary studies at the Fund recommended a general quota increase of 50 per cent along with some selective increases. The general increase was whittled down, despite Britain's and Canada's preference for larger quotas, to 25 per cent by the Group of Ten (G-10) industrialized countries. This now formed the basis for the Fund's studies of quota revisions. Several methods of mitigating the immediate impact of quota increases on the liquidity position of the developing countries were aired in discussions and memoranda. The Fund's articles of agreement [III(4)(a)] allowed the institution to reduce the gold contributions of members with low reserves, and this was India's own preferred method of dealing with the problem. The Bank advised the government to press for a 'complete waiver of gold subscription' for countries with low reserves, but announce at the same time India's willingness to pay its gold quota in full. 'Our argument for a complete waiver of gold subscription can then be made to appear ... disinterested and objective ...', Bhattacharyya counselled the Finance Ministry. 'Outright payment of gold' by India, the Governor also told officials in Delhi, would strengthen its position as a member of the 'First Five', and help the 'tranche position'. 'This would be of considerable help to us in the immediate future if we have to undertake next year an operation of the 1961 type to fulfil our current repurchase obligations.' Finally, by strengthening India's advocacy of Art. III(4)(a), it might prove to be of some help 'on the next occasion of a quota increase'.

Mitigation proposals did not make much headway in the face of opposition from a majority of the industrialized countries. Eventually, a compromise was hammered out which avoided recourse to Art. III(4)(a) and offered relief through the technique of special drawings with some relaxation of repurchase requirements. Countries pleading hardship were to be given the facility of an additional special drawing, which would not take borrowers into a higher credit tranche. These were to be repaid in five years. With the G-10 endorsing this compromise approach, the rest of the journey was quite smooth, and the Governors of the Fund approved two resolutions to sanction a 25 per cent general increase in quotas and special increases for sixteen countries.

India managed to hold on to its fifth position, and thus the right to nominate its own Executive Director, by the proverbial whisker. Substantial special increases were clearly indicated for France, Canada, Germany, and Japan, but the last three countries, in particular, were restrained in pressing for quota increases to the full extent warranted by technical calculations. Addressing the Board of Governors of the Fund in Tokyo in 1964, the Finance Minister, T.T. Krishnamachari, pointed out that not all the considerations determining the quota structure could be expressed or compressed in statistical formulas. TTK's advice was reflected in the final outcome, which was made possible by Canada and Japan, both of whom would have secured larger quotas had technical calculations been the sole basis of the quota revision, settling for \$740 million and \$725 million respectively, against the Indian quota of \$750 million. India was, however, put on notice that it could not expect similar consideration when the next round of quota increases was undertaken.

The increase in the Indian quota amounted to \$150 million. Of this \$37.5 million had to be found in the form of gold in the immediate future. The Bank's advice to the government was to consent to the increase and accept the quota in full, rather than in instalments as some proposed, meet the gold obligation by making a special IMF drawing, and deposit it immediately to secure the full benefit of the quota increase. According to Bhattacharyya, India should not allow Canada or Japan to outstrip its quota even temporarily. India, he also argued, should declare its intention to repurchase the drawing in three to five years, as this would postpone the first repurchase obligation to 1968 when repurchases on other drawings would be out of the way.

Various options of buying the gold were considered, including directly from the Bank of England and the Federal Reserve Bank of New York, rather than from the London or New York market. There were also some misgivings that the arrangements the Fund envisaged for the special drawing to purchase gold might necessitate paying a premium on the metal and bearing a higher cost of transporting it, should the government so decide, to Nagpur. An easier option was to transfer \$37.5 million (approximately Rs 17.8 crores) worth of gold from the Reserve Bank's holdings to the Fund's account in India. Apart from enabling India to take advantage of the higher quota immediately, it would also save the expense of transporting gold to its final depository.

It was pointed out in chapter 17 that the Issue Department's gold assets were augmented by about Rs 16 crores early in 1965 by taking over stocks of confiscated and indigenously produced gold. The object of this manoeuvre was to enable foreign exchange to be released to finance imports and debt repayments while keeping the Issue Department's total stock of gold and foreign securities above the section 33 minimum of Rs 200 crores. The IMF special drawing would, in principle, now enable the opposite substitution to be made in the overall composition of the Issue Department's reserves of gold and foreign exchange. But the withdrawal of nearly Rs 18 crores of gold would bring its gold holdings down from Rs 133.76 crores to Rs 115.89 crores, or only Rs 0.89 crore above the statutory minimum for this particular component of the currency cover. In addition, some doubts existed over the permissibility of using the special drawing to restore reserves rather than buy gold.

The idea of selling silver, whose price was quite high at this time in the international market, as a substitute for the special drawing was considered briefly. It was abandoned after the Bank cautioned the government that refining and assaying silver to international standards would take far too long for India to be able to meet the IMF obligation with the proceeds of its sales. Besides, Indian sales of the metal could depress international prices and draw unwelcome attention to a hidden source of foreign exchange. Fresh tidings from Washington also indicated that India had until the end of December to make its payment to the IMF and that the special drawing could be used to replenish reserves. This clinched the issue in the Bank's mind, and Bhattacharyya informed the government of its view that there was no special advantage to avoiding the special drawing which would not affect India's other drawing powers at that institution in any way. J.J. Anjaria, the Indian Executive Director at the Fund, who had earlier backed the plan to sell silver and conserve the special drawing for another rainy day, also came round to Bhattacharyya's view that 'the decision on silver need not be rushed'. So that finally, the obligation to pay $37.5 million to the IMF in gold was met by drawing down gold holdings in the Reserve Bank's Issue Department, and using the proceeds of the special drawing to replenish the latter's foreign exchange assets. The payment was completed on 28 February 1966.

Additional Unpublished Sources

BF-19A	Increase in Resources of IMF and IBRD
BF-29B-1965	Increase in Resources of the Fund and the Bank
301(A)	Purchase of Gold