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National Interest Analysis [2009] ATNIA 11

with attachment on consultation

Proposed Amendment of the Articles of Agreement of the International Monetary Fund to Enhance Voice and Participation in the International Monetary Fund — adopted by the IMF Board of Governors on 28 April 2008

Proposed Amendment of the Articles of Agreement of the International Monetary Fund to Expand the Investment Authority of the International Monetary Fund — adopted by the IMF Board of Governors on 5 May 2008

Proposed Amendment of the Articles of Agreement of the International Bank for Reconstruction and Development to Enhance Voice and Participation in the International Bank for Reconstruction and Development — adopted by the IBRD Board of Governors on 30 January 2009

[2009] ATNIF 1

NATIONAL INTEREST ANALYSIS: CATEGORY 1 TREATY

SUMMARY PAGE

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[2009] ATNIF 1

Nature and Timing of Proposed Treaty Action

The proposed treaty actions are the formal acceptance by Australia of two amendments to the Articles of Agreement of the International Monetary Fund (the IMF) and one amendment to the Articles of Agreement of the International Bank for Reconstruction and Development (the World Bank).

2. The IMF Board of Governors approved the Proposed Voice and Participation Amendment on 28 April 2008, and the Proposed Investment Authority Amendment on 5 May 2008. The amendments will enter into force on the date when the IMF certifies that acceptance has been received from three-fifths of its members, cumulatively holding 85 per cent of the total IMF voting power. As this is a separate process for each amendment, the two amendments are unlikely to enter into force on the same date. Once in force, the amendments will bind all IMF members, including those that have not notified formal acceptance. The principle that underlies members' relative shareholding (or quota) in the Fund is their relative position in the world economy. Currently in the IMF, each member is allocated 250 basic votes and has one additional vote for each SDR 100,000 (the Fund's unit of account) in quota.

3. The World Bank Board of Governors approved the Proposed Voice and Participation Amendment on 30 January 2009. The amendment will enter into force on the date three months after the World Bank certifies that acceptance has been received from three-fifths of its members, cumulatively holding 85 per cent of the total World Bank voting power. The fundamental principle underlying the allocation of shares in the World Bank is that members' shareholding should reflect their relative position in the world economy. This principle has been implemented through the use of IMF quotas, which have formed the basis for calculation of shares to new members and for allocation of additional shares to current members. Currently in the World Bank, each member is allocated 250 basic votes and has one vote for each share of stock held.

Overview and National Interest Summary

4. The Proposed IMF Voice and Participation Amendment aims to improve the voice and participation of low-income States in the IMF by increasing their voting share and staffing resources. These increases aim to enhance the legitimacy of the IMF as an international financial institution with near-universal membership.

5. The Proposed IMF Investment Authority Amendment would expand the investment mandate of the IMF and allow proceeds from IMF gold sales to be used to create an investment endowment. These changes aim to provide the IMF with a stable and sustainable income base, not mainly dependent on income from lending.

6. Similarly, the Proposed World Bank Voice and Participation Amendment aims to improve the voice and participation of developing and transition States in the World Bank by increasing their voting share. This increase aims to improve the effectiveness and legitimacy of the World Bank as the leading global development institution and enhance the influence that developing and transition countries have over governance, policies and decision-making in the World Bank.

7. These amendments introduce no substantive changes to Australia's obligations to either the IMF or the World Bank. Australia's actual IMF quota and World Bank shareholding would not alter as a result of the voice and participation changes, while its voting share in both organisations would decline only marginally. However, Australia has an interest in seeing these amendments accepted as they would likely improve the effectiveness of the IMF and the World Bank in promoting economic and financial stability, international development and poverty reduction.

Reasons for Australia to take the Proposed Treaty Action

8. The IMF advances Australia's interests by supporting stability in the global economy through promoting international monetary cooperation, exchange stability, and orderly exchange arrangements; fostering economic growth and employment; and providing temporary financial assistance to members, helping to ease balance of payments adjustment. Australia considers that the IMF is a central forum for multilateral consultation and cooperation on monetary and financial issues as well as in promoting international financial and monetary stability. The global financial crisis and global recession have highlighted the urgency of accelerating changes to the IMF so that it can more effectively fulfil its mandate. These reforms include increasing the IMF's lending resources, further quota and voice reform, review of lending facilities, and institutional governance reform. Australia, as a small, open economy, benefits from an effective IMF that can fulfil its mandate. The proposed amendments will assist the IMF's effectiveness in achieving these goals.

9. The World Bank advances Australia's interests by supporting international economic development and poverty reduction in developing and emerging economies through the provision of loans, grants, guarantees, equity, risk-management products and non-lending analytical and advisory services. Australia's foreign aid is focused on increasing less developed countries' economic growth and helping them to achieve the Millennium Development Goals. As well as helping to meet the needs of the world's poor, it is in Australia's own interest to tackle poverty around the world as part of a wider strategy to deal with the impact of terrorism, climate change, pandemics and refugees on Australia. Failure to do so will result in even greater costs in the future.

10. The proposed amendment to increase basic votes is part of the World Bank's wider reform agenda, which seeks to enhance the effectiveness of the World Bank in achieving its objectives. An increase in basic votes for all members at the Bank will strengthen the relative voting power of small and low-income members, most of which are developing or transition countries, giving them greater representation in the Bank. Successful reform of the World Bank, to better reflect global developments and increase its legitimacy with developing countries, will enhance the World Bank's role in the international development architecture and ensure that funds invested on behalf of Australian taxpayers are best utilised.

IMF Voice and Participation Amendment

11. This amendment aims to increase the voice and participation of low-income States within the IMF by increasing their relative voting power and administrative resources.

12. Improving voting structure: Voting share in the IMF is determined by a mixture of basic votes and quota-based votes. Basic votes are allocated equally to all members, reflecting the principle of equality of states. Quota-based votes are allocated on the basis of members' quotas, which broadly reflect the relative economic weight or position of each member in the global economy. Quota-based votes have increased significantly since the establishment of the IMF in 1945, whilst the number of basic votes allocated to each State has remained unchanged. This has resulted in the erosion of relative voting power of low-income States in the IMF. There are currently 2,217,033 votes, of which 46,500 are basic votes (250 for each of the IMF's 186 members).

13. This amendment proposes to triple the number of basic votes of each State from 250 to 750 and to ensure thereafter that the proportion of basic votes to total votes remains constant. The addition of 500 votes per State will result in a decline of relative voting share for larger IMF member countries (those whose voting share is above the average voting share of the full membership) and an increase in relative voting share for smaller and low-income developing countries (whose voting share is below the average).

14. The enhancement of the voice of low-income IMF members through the increase in basic votes and increase in staffing resources is part of a wider reform of IMF quota and voice – in particular to better align the quota and voting shares of dynamic emerging market economies (EMEs) with their weight in the global economy. The total reform package will result in a 2.7 percentage point shift in voting share from advanced economies to EMEs and other developing economies. The voting shares of some G-7 countries (such as the United Kingdom and France) will be reduced, although their proportion of total votes will remain far higher than that of poorer countries. The countries of the European Union lose an aggregate 1.6 percentage points in voting share. The recipients of the largest percentage point increases in voting share are China, Korea, India, Brazil and Mexico.

15. Australia's quota is SDR 3.2 billion (around A$6.1 billion at 3 June 2009 exchange rates) and our voting share is currently 1.47 per cent. Broadly, Australia is neither over- nor under-represented in the Fund but will lose voting share due to quota increases provided to others and due to the increase in basic votes. When the reform package is implemented, Australia's voting share will decline to 1.31 per cent. These changes are not expected to significantly alter the dynamic within our constituency or our influence within the Fund.

16. Improving staff resourcing: The IMF is governed by its 186 member Ministerial level Board of Governors, which includes the Treasurer as Governor for Australia, and a full-time resident Executive Board of 24 Executive Directors. Five Executive Directors are appointed by the five member countries having the largest quotas in the Fund. The remaining 19 Executive Directors are elected to represent constituencies of countries (three of which are single member constituencies). Some of these constituencies have a large number of members with close IMF engagement through financial assistance, policy advice, and technical assistance. The consequent heavy workload places a considerable burden on Directors and their offices, which risks reducing their voice and participation at the IMF. This amendment proposes to allow the Board of Governors to adopt rules to enable an Executive Director elected by more than a specified number of members to appoint two Alternate Executive Directors (as opposed to one). Under the initial rules adopted by the Board of Governors, the two African constituencies will be eligible to appoint an additional Alternate Executive Director once the amendment enters into force. This is in recognition of the large size of the two African constituencies, and the heavy workload generated for their constituency offices by the advisory and financing role the IMF plays in these countries.

World Bank Voice and Participation Amendment

17. In a similar structure to the IMF, voting share in the World Bank is determined by a combination of basic votes and share votes. Basic votes are allocated equally to all members, reflecting the principle of equality of states. Share votes are allocated on the basis of shareholding (one vote for each share of stock held) and are indicative of the relative economic weight and role of each member in the global economy. As with the IMF, the relative voting power of developing

and transition countries has eroded over time, in part because the number of basic votes has remained unchanged while the number of share votes has increased markedly. At present, the total number of votes held by member states of the World Bank is 1,620,815, of which 46,500 are basic votes (250 for each of the Bank's 186 members).

18. The proposed Voice and Participation Amendment will increase the number of basic votes allocated to each member from 250 to 500 and then ensure the proportion of basic votes to total votes remains constant into the future. This will increase the relative voting share of small and low-income countries and help protect their share into the future.

19. When implemented, the voice and participation reform package (which includes an increase in basic votes and use of unallocated shares) will result in a 1.4 percentage point shift in voting share from developed to developing and transition countries. Developing and transition countries' voting share will increase from 42.6 per cent to 44 per cent of total voting power. Australia has 24,464 shares valued by the Bank at US$2.95 billion (A$3.57 billion at 3 June 2009 exchange rates) in the World Bank and a voting share of 1.53 per cent. Australia's voting share will decrease to 1.49 per cent of total voting share as a result of the reform package. These changes are not expected to significantly alter the dynamic within our constituency or our influence within the World Bank.

IMF Investment Authority Amendment

20. The IMF has traditionally relied on income from its lending activities to finance its general administrative expenses. In recent years there has been a sharp decline in IMF credit outstanding, which has significantly impacted the budgetary position of the IMF. In the 2007-08 financial year a deficit of US$165 million was recorded, funded from reserves, on total expenditure of US$954 million.

21. The severity of the global recession has resulted in a substantial increase in IMF lending. This increase will have a positive impact on the IMF's income and financial position over time. However, reform of the income model is required to diversify the income base and reduce reliance on lending as an income source, ensuring that the IMF can finance its activities when lending volume subsides.

22. Currently, the IMF Articles provide that the Fund can only invest in the marketable obligations of members or international organisations. The Proposed Investment Authority Amendment would remove this restriction and allow an open-ended investment authority. However, it would also require that all investments be made in accordance with rules and regulations (for example, imposing restrictions on types of investments and setting risk tolerance levels) adopted by the Fund by a 70 per cent majority of total voting power. The Amendment would also enable the IMF to place all profits from the limited sale of IMF gold into an investment endowment.

23. Expanding the IMF's investment authority would increase expected investment returns and bring the IMF's authority more into line with that of other international financial institutions.

24. Channelling the proceeds from limited IMF gold sales to an investment endowment would increase IMF income by generating periodic interest returns, which would be directed to meeting future administrative expenses.

25. These changes will benefit Australia by improving the sustainability of the IMF's finances and thus facilitating the continued effectiveness of the IMF in promoting global economic and financial stability.

Obligations

26. These amendments would introduce no substantive changes to Australia's current obligations to either the IMF or World Bank. Australia's voting share in both organisations would decline only marginally.

Implementation

27. Australia's current obligations to the IMF and World Bank are outlined in the *International Monetary Agreements Act 1947*. The IMF and World Bank Articles of Agreement form Schedule 1 and Schedule 2 to the Act. In the past, it has been necessary to amend the Act to update these Schedules for each amendment to the IMF or World Bank Articles of Agreement. A Bill has been introduced into the Parliament seeking authority to automatically reflect these amendments, including the three amendments covered by this Analysis, in the Schedules once they have entered into force for Australia.

Costs

28. Formal acceptance of these amendments is not expected to result in additional costs to the Australian Government, or State or Territory Governments.

29. As a major world gold producer, Australia has a particular interest in planned IMF gold sales, which are awaiting formal approval by the IMF Executive Board. These sales are expected to have a minimal impact on the gold price. The IMF operates under a long standing principle that it has a systemic responsibility to avoid causing disruptions that would adversely impact gold holders and gold producers, as well as the functioning of the gold market. It has emphasised that gold sales would be conducted under stringent safeguards, including:

- strictly limiting sales to 403 tonnes — the gold acquired since the date of the second amendment of the Fund's Articles of Agreement in 1978;

- conducting sales in an orderly and transparent manner and phased over a substantial period (perhaps 3 to 4 years);

- exploring the possibility of selling gold "off-market" to official holders, which would result only in a redistribution of official holdings; and

- conducting any on-market sales through the current Central Bank Gold Agreement (and any successor Agreement) to ensure they do not add to the announced volume of sales from official sources.

30. The IMF has consulted with gold market stakeholders including central banks, participants in the London Gold Market and the World Gold Council (whose membership includes two Australian producers), to gauge market sentiment and the expected impact of the sale. Stakeholders indicated that they are comfortable with the proposal and that the specified safeguards would help ensure gold market disruptions are minimal.

Regulation Impact Statement

31. The Treasury has assessed the implementation of the Treaty against criteria in the *Best Practice Regulation Handbook*. This regulatory option has no impact on business and individuals, or on the economy. Therefore, a Regulation Impact Statement or Business Cost Calculator report is not required.

Future Treaty Action

32. Any future amendments to the IMF or World Bank Articles of Agreement would be subject to Australia's domestic treaty process, including consideration by the Joint Standing Committee on Treaties.

Withdrawal or Denunciation

33. The amendments do not alter the withdrawal or denunciation provisions specified in the IMF and World Bank Articles of Agreement. Any member may withdraw from the IMF or World Bank at any time by transmitting a notice in writing to the IMF or World Bank at its principal office. Withdrawal becomes effective on the date such notice is received by the IMF or World Bank. A decision to withdraw from the IMF or World Bank would be subject to the domestic treaty process.

Contact Details

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ATTACHMENT ON CONSULTATION

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[2009] ATNIF 1

CONSULTATION

34. A formal domestic consultation process was not undertaken prior to these amendments being adopted by the IMF and World Bank Board of Governors. Consultation was considered unnecessary on the basis that there were no domestic stakeholders who would likely be affected by the proposed amendments who had not already been consulted directly by the IMF or the World Bank. Australia's position on these issues was clearly stated in the public domain and interested parties were afforded transparency through publicly available documents and statements.

IMF Voice and Participation Amendment

35. As a member of the G-20 Management Troika from 2005 to 2007, Australia put forward its position in favour of reform of IMF quota and representation. In October 2005 Australia published a paper: *A Framework for a Review of the International Financial Institutions,* proposing that the G-20 develop principles for reform of voice and representation at the IMF and World Bank. As chair of the G-20 in 2006, Australia released another paper on IMF quota reform: *Quota Reform and the G-20*. This paper included consideration of changing basic votes as one mechanism for enhancing the voice of developing countries. Following the G-20 meeting in Melbourne in November 2006, the then Treasurer issued a press statement reiterating Australia's advocacy of IMF quota reform.

36. In September 2006, Australia's then IMF Governor voted in favour of a resolution to increase the quotas of the four most under-represented countries. The *Treasury Annual Report 2006-07* and the *Australia and the International Financial Institutions 2005-06* report, both tabled in Parliament, described Australia's support for the quota reform outlined in that resolution.

37. Australia's plenary statement at the 2006 IMF Annual Meetings indicated support for further reform of IMF representation. At the 2007 Spring and Annual Meetings of the IMF, Australia, on behalf of its constituency, reiterated this support and called for an increase in basic votes. In his

constituency statement at the 2008 IMF Spring Meeting just prior to voting on the proposed amendment of the Articles, the Treasurer, the Hon. Wayne Swan MP, stated Australia's full support for the quota and voice reform package and encouraged other nations to vote in favour of the amendment.

38. Through these channels it was clear that Australia's position was in support of the principle of shifting aggregate voting share from advanced to developing countries, an increase in basic votes, and an increase in the number of Alternate Executive Directors for large constituencies. Australia argued that the changes should be considered as a package and that it was willing to be flexible on the individual aspects of the reform, provided that the package as a whole enhanced the legitimacy, and therefore the effectiveness, of the IMF.

World Bank Voice and Participation Amendment

39. Following agreement on IMF quota and voice reforms in April 2008, shareholders turned their attention to voice and participation reform at the World Bank. Australia has been a strong supporter of the World Bank's voice and participation reform agenda and has sought to pursue reforms that will enhance the legitimacy, relevance and effectiveness of the institution, enabling it to respond flexibly and rapidly to members.

40. At the April 2008 World Bank Spring Meeting, the Treasurer, in his capacity as Australia's Governor of the World Bank, lodged a statement on behalf of Australia's constituency. In this statement the Treasurer provided support for the World Bank's voice and participation reform agenda and specifically for shareholding realignment and improvements to Bank responsiveness, particularly for smaller member countries.

41. The Treasurer was a lead speaker at the October 2008 World Bank Annual Meeting in support of a proposed voice and participation reform package, which includes: increasing developing country voting power through a doubling of basic votes and use of unallocated World Bank shares; additional representation at the Executive Board for Sub-Saharan Africa; support for open merit-based selection processes for the next President; and support for measures to improve Board effectiveness and World Bank engagement with clients.

42. The package also includes a medium-term work program to consider options for realigning shareholding and voting power to better reflect the increased economic weight of emerging economies. The Treasurer's constituency and country statements at the 2008 Annual Meetings reiterated Australia's support for the World Bank's voice and participation reform package and for further efforts by the World Bank and the IMF to pursue governance and shareholding reforms.

43. On 14 January 2009, the Treasurer voted in favour of a World Bank Resolution to formally accept the voice and participation reform package discussed at the Annual Meeting. The Resolution was adopted by the World Bank Board of Governors on 30 January 2009.

44. Throughout the voice and participation reform discussions, it was clear that Australia was strongly in support of increasing developing and transition country voting power and overall representation in the World Bank, including through an increase in basic votes for all member States.

IMF Investment Authority Amendment

45. The *Australia and the International Financial Institutions 2005-06* report stated that Australia supported the implementation of a new IMF income model. The details of this model were presented in a report to the IMF by the Committee to Study Sustainable Long-term Financing of the IMF, which was published on 31 January 2007. The report included the proposal for the limited sale of IMF gold and a recommendation for the current technical amendment in relation to gold sales.

46. During the drafting of the proposed amendments, the IMF consulted with gold market stakeholders including central banks, participants in the London Gold Market and the World Gold Council, to gauge market sentiment and the expected impact of the sale. The World Gold Council's membership includes two Australian producers. All the stakeholders consulted indicated that they were comfortable with the proposal and that the specified safeguards would help ensure gold market disruptions are minimal.

47. The Department of Resources, Energy and Tourism and the Minister for Resources and Energy were consulted in relation to the gold sales proposal.

48. Prior to voting on the proposed amendment, the Treasurer, in his constituency statement at the 2008 IMF Spring Meeting, stated that Australia supported the proposed package of income reforms.