G20 BRASIL 2024

BUILDING A JUST WORLD
AND A SUSTAINABLE PLANET

International Financial Architecture (IFA) Working Group

PRESIDENCY NOTE

IMF QUOTA SHARE REALIGNMENT

2024

I. INTRODUCTION

The IMF is a unique, and uniquely valuable institution with a nearly universal membership, currently including 191 countries. Its roles as provider of macroeconomic information and research, policy analysis, advice and surveillance, technical assistance, and lender in times of economic distress are, for all practical purposes, currently irreplaceable.

II. GOVERNANCE OF IMF

The quota-based governance structure is the cornerstone of the nature of the IMF as an international financial institution. Quotas play different but closely related roles: they determine the contribution of each member to the Fund, their share in general SDR allocations and their voting power, and they are an integral part of the policies regulating access to the Fund's resources. As such, quotas are critical for the Fund's financial soundness, effectiveness, and legitimacy.

While the IMF Articles of Agreement do not prescribe how quotas should be set, quota shares have been historically related to, but not strictly determined by, factors including the political influence of member countries, their economic weight, degree of economic and financial integration, and capacity to contribute to the IMF. The quota shares change from time to time, by agreement of the membership. However, these changes are slow, and generally lag the transformations in the structure of the world economy, implying that the distribution of quotas, the voting power of member countries, and their influence in the Fund's Executive Board carries the weight of historical legacies. This can lead to significant misalignments in the quota shares when compared, for example, with current country shares in global GDP or even with the calculated quota shares according to the current quota formula.

Misalignments such as these help to explain why several member countries, especially heavily under-represented middle-income and low-income emerging market and developing countries (EMDCs), have long sought IMF reforms. Yet, the process of rebalancing for fairness in representation and influence has been slow and halting, leading to a growing feeling of frustration among large swaths of the membership, as well as diverging views in terms of what needs changing, how, and to what end. None of these bodes well for the functioning of the IMF, its representativeness, and legitimacy. These feelings have intensified with the past two General Review of Quotas (the 15th and 16th GRQs) which failed to deliver on the promises made in 2010, despite the progress made in the 14th GRQ.

Moreover, beyond governance (which concentrate on the issue of quota shares), an adequate level of quotas in line with economic weight, capacity to contribute and potential need for IMF financial support is critical to ensure that the Fund remains financially sound, with sufficient resources to face tail risks to global financial stability, and capable of properly serving the membership. A well-resourced and legitimate IMF will remain as the cornerstone of an effective global financial safety net.

In this context, the G20 has consistently acknowledged "the urgency and importance of realignment in quota shares to better reflect members' relative positions in the world economy, while protecting the quota shares of the poorest members". In the communiqué of its Finance Ministers and Central Bank Governors' meeting in July 2024, the G20 welcomed "the IMF Executive Board's ongoing work to develop by June 2025 possible approaches as a guide for further quota realignment, including through a new quota formula", under the 17th General Review of Quotas and availed itself "to act constructively to help build momentum at the IMF Executive Board."

III. THE CURRENT QUOTA FORMULA

Since the creation of the Fund, a quota formula (modified only three times throughout the Fund's history) has been used to guide the distribution of quotas through "calculated quota shares" (CQS). The quota formula can help to inform quota realignments, but this is not mandatory, and has been limited in practice.

The current quota formula was a significant advance when compared with the previous cumbersome 5-formula system, through which calculated quota shares would be defined after members' quotas were calculated by different formulae. In contrast, the current formula yields the calculated quota shares directly, as the weighted sum of the shares in GDP Blend (60% market + 40% PPP), Openness, Variability and International Reserves, compressed by a factor of 0.95 to narrow the distribution. That is, the Quota Share (QS) for country i (with all variables calculated as shares of the total) is:

$$QS_i = (0.5 \text{ GDP Blend}_i + 0.3 \text{ Openness}_i + 0.15 \text{ Variability}_i + 0.05 \text{ International Reserves}_i)^{0.95}$$

- GDP *Blend* is measured by the composite of 3-year averages of market GDP (60%) and PPP GDP.
- *Openness* is measured by the relative size of current payments and receipts for goods, services, income and transfers.
- *Variability* is the standard deviation for current receipts and net capital flows.
- *International reserves* include official foreign exchange assets in reserve currencies, holdings of Special Drawing Rights (SDR), reserve position in the Fund, and monetary gold.

Openness and *Variability*, amounting to 45 per cent of the outcome, shape in a major way the distribution of quotas in favor of (financially or commercially) open economies, mostly to the advantage of developed countries and disadvantage of EMDCs.

IV. APPROACHES TO REALIGNMENT

A quota increase could take place through different distribution mechanisms. For example, it can be equiproportional to the current distribution of quotas (which would not deliver any realignment); alternatively, a selective distribution will share the quota increase in line with the quota formula, and realign quota shares inasmuch as actual quotas differ from calculated quotas. *Ad hoc* distribution of quotas by definition leads to realignment and is usually conceived with that purpose. Accordingly, quota realignment has often been delivered through *ad hoc* approaches, rather than the application of the quota formula.

Agreeing on a new quota formula can be challenging; and such an agreement would stand as an additional step before an effective quota share realignment. An ad hoc approach seems to be more flexible, but agreeing on the parameters of an ad hoc allocation of quotas could also be challenging.

Changes in the quota formula could be considered ahead of a selective distribution of quotas. If the current formula is taken as the point of departure, the potential for change would include:

- Changing the weights of the variables (including, possibly to zero);
- Changing the concept or the methodology to calculate the variables (for instance, by modifying the timeframe of the variables);
- Adding a new variable;
- Changing the compression factor (including, possibly to 1).

These options are reviewed below.

Changing Weights

The discussion on redefining the weights of the variables has centered on: reducing or dropping Variability; increasing the weight of the GDP Blend; and changing Openness.

The case for dropping or reducing the weight of Variability was made in the 2013 Quota Formula Review and in subsequent staff reports. The arguments in favor are that the concept of Variability is methodologically weak; not a good proxy for potential demand for Fund resources; introduces volatility to calculated quota shares; is highly correlated to Openness, and it tends to boost the quota share of small and medium (mainly advanced) open economies.

Some chairs at the IMF Board have stated in the past that they would be open to dropping Variability, if its weight is transferred to Openness; however, others have argued that transferring the weight of Variability to Openness would defeat the purpose of the reform, since this would not transfer shares to dynamic EMDCs. Hence, they would argue in favor of transferring the weight of Variability to GDP Blend.

There have also been proposals to increase the weight of the GDP Blend beyond a drop in Variability, which would imply that the weight of Openness would fall (since keeping the weight of International Reserves at 5% has been broadly supported in the 2013 Review). Still others would oppose any change to Variability.

Changing Concepts or Methodologies

The IMF Board has discussed several proposals to change concepts or methodologies in the quota formula.

Changing the GDP Blend

The current blend in the GDP variable has been agreed on after delicate negotiations, but many EMDCs have argued GDP at market prices is too volatile and underestimates the economic weight of less developed economies, because they tend to have undervalued exchange rates due to lower cost of non-tradables. In turn, GDP in PPP has been widely used globally, and its methodological shortcomings have been largely addressed by the International Comparison Program (ICP); this is generally considered a better comparator among diverse economies than market GDP, and indeed, aggregation of GDP on PPP terms is used by the IMF to estimate global growth. As an alternative, arguments in support of market GDP include the fact that it is a better established and more universal methodology, that better captures the global share of the economy as it uses the exchange rates prevailing in BoP transactions. It is also more relevant from the perspective of financial flows.

Changing Openness

Openness seeks to capture members' integration into the global economy. Despite criticisms about conceptual flaws and measurement issues, there has been sufficient support to keep Openness in the quota formula. However, some features of the methodology used to calculate Openness have been disputed. In particular, there is potential double-counting by using gross flows rather than value added, and the merits of including intra-currency union trade into the calculation are questionable, as it may unduly inflate the degree of openness of an economy. On the other hand, it has been argued that accounting for intra-currency union trade is a sign of the ability of countries to reach a high level of economic integration.

Although there has been no consensus about how to address these issues related to Openness in the formula itself, ad hoc approaches have been used or proposed in the past to mitigate possible distortions. One option that has not yet commanded consensus was to define a cap to Openness in relation to GDP; another possibility is to define a cap on the weight of Openness in the calculated quota. Changing the weight of financial openness has also not obtained sufficient support.

Introducing New Variables

Voluntary Financial Contributions (VFCS): Some members have proposed the introduction of VFCS (contributions to NAB and BBA, to PRGT and RST, contributions to the Fund's capacity development activities) in the quota formula, and this has been technically explored by Fund staff. However, several members have expressed strong opposition to this move. Then again, as seen below, there seems to be some disposition, although not consensual, to consider ad hoc ways to account for exceptionally high VFCS.

Population: Some members and civil society organizations have suggested adding population to the formula, but the proposal has never gained sufficient traction to lead to technical studies by Fund staff.

Changing the compression factor: The compression factor reduces the dispersion in the distribution of quota shares. A higher compression factor would favor most EMDCs (indeed, all countries with quota shares below 1/191, or 0.52%), and there have been proposals on the table to that effect. However, given the delicate compromise around the current compression factor, there seems to be little appetite to reopen the discussion at this point.

Other Approaches to Realignment

Selective Plus GDP-Based ad hoc Distribution: The 14th GRQ Solution

Given the pressure for a quota increase after the GFC, the solution found at the 14th GRQ was to complement a selective distribution (corresponding to 60% of the quota increase) with an ad hoc distribution to reduce the gap between actual quota shares and the quota shares calculated by the compressed GDP Blend and other ad hoc measures, specifically: (i) the uniform proportional gap-reduction target of EMDCs would be double those of AEs; (ii) protection of quota shares of the poorest members; (iii) protection of gains (from the selective distribution) of countries underrepresented under the formula; and (iv) for all other countries, a stop-loss mechanism determined by the higher of GDP Blend or Calculated Quota Share (CQS).

The 14th GRQ left important lessons: (i) the current quota formula has not been the sole guide for a quota increase; (ii) hence, out-of-lineness (OOL) measured by the quota-formula CQS is not the only indicator of underrepresentation or overrepresentation; and (iii) a combination of ad hoc distribution and ad hoc measures (caps, filters, protections, and voluntary reductions) can deliver some realignment goals and help gather sufficient support among members.

Protection of the Poorest Members

There has been an important consensus around the need to protect the poorest members, which was applied in the 14th GRQ and reiterated by the IMFC and the Board of Governors since then. What needs to be defined now is the extent of this protection which, at the 14th GRQ, covered only part of the PRGT-eligible countries meeting a certain IDA income cut-off. Currently, there is growing support to enhance protection to all PRGT-eligible countries.

Protection of Small Developing States (SDS)

There is recognition that SDS have specific needs related to their vulnerability to exogenous shocks. Therefore, in a GDP-oriented quota increase, one could find it appropriate to protect the quota share of SDS. Moreover, given the very small quota shares of these countries (SDS that are not LICs), the cost of protecting them for the rest of the membership is very small. However, there has been no consensus yet about protecting their quota shares beyond SDS already protected as part of the poorest members.

Soft GDP Anchor

A soft anchor based on GDP could be established in case of an exclusively selective distribution, in order to limit further deviations from GDP-based CQS for those countries that are already beyond a certain level of over- or under-representation vis-à-vis their GDP-calculated quota share.

A GDP Filter

A GDP filter could be used to determine which countries would "actively" participate in the quota realignment.

V. CHALLENGES TO THE QUOTA REFORM

It is obvious that reforming the distribution of quotas is essential for the continuing relevance, efficacy, and legitimacy of the IMF. However, reform proposals are invariably examined through the prism of which countries would win (likely dynamic EMDCs, primarily in Asia) at the expense of which other countries (highly over-represented members, especially small, advanced economies). In this context, commanding more than 85% voting power support has proven to be challenging, given such an agreement implies that over-represented members accept to reduce their position. Such zero-sum perspective to quota shares realignment overlooks the fact that improving representativeness in the institution enhances overall legitimacy and effectiveness, with benefits for the membership as a whole. Since the creation of the IMF 80 years ago, quota share realignments occurred ten times, albeit in a very limited manner for some of them. Modifying the quota formula has been even more challenging, with only 3 revisions. More recently, the impulse to reform has been blocked by the resistance to change the current asymmetries, given the required degree of consensus which, in practice, must include the over-represented members.

This fundamental obstacle has been hindering the progress of the reform proposals, even though reforms could make the Fund more relevant to its members, especially developing economies and in particular low-income, small, vulnerable countries with significant BoP fragilities and large SDG- and climate-related financing gaps.

VI. RECENT REFORM ATTEMPTS

The last and most important change in the governance and financial structure of the IMF was the so-called 2010 Governance and Quota Reform, following the Global Financial Crisis, in which the G20 played a pivotal role. It was agreed then that there should be a transfer of quota shares from the advanced economies to EMDCs in order to reflect the transformations in the global economy, and that GDP would have a stronger weight in the distribution of quotas. It was also agreed that the poorest members would have their quota shares protected. In line with these goals, the quota increase was distributed 60 percent according to the quota formula and 40 percent in an ad hoc manner, mostly based on GDP. It was also agreed that two advanced European economies' chairs at the Executive Board would be transferred to EMDCs.

The 2010 Reform also agreed on the principles that should guide the redefinition of the quota formula: (i) simplicity and transparency; (ii) consistency with the multiple roles of quotas; (iii) broad acceptability of results by the membership; and (iv) statistical feasibility. In the subsequent discussions, there was broad agreement that these principles remain valid and should continue to guide any quota formula reform. In this context, it is significant that the quota formula that had been agreed in 2008 was deemed incapable of delivering the adjustment required by the 2010 reform, and hence failing to meet principle (iii).

The purpose of the 2013 review (determined by the 14th GRQ resolution) was to find ways to realign the quotas in order to better reflect the economic weight of dynamic economies. However, by the time the review concluded, the momentum for reforming the IMF was waning and no proposal to change the quota formula could garner sufficient support. The most meaningful conclusion of the review was that "Variability" would not be a good proxy for potential demand for Fund resources (as had been envisaged), and was largely redundant with respect to Openness, a variable that, itself, generated strong divisions among members. In the end, even though there was considerable support to drop Variability from the formula, there was not enough support to reach a decision, or even agreement on how to redistribute the weight of Variability to other variables.

The fact that there was no agreement to increase quotas in the 15th GRQ reduced the impetus to change the formula. In the end, the agreement reached in 2019 did not lead to any change in quotas, but only shifted the composition of borrowed resources from bilateral borrowing agreements (BBAs) to the New Arrangements to Borrow (NAB). The Board of Governors resolution approving the 15th GRQ determined that the 16th Review should tackle the issue of a new quota formula and the realignment of quota shares, mandating the Executive Board to "continue the process of IMF governance reform, including a new quota formula as a guide." After several years of debate, the 16th GRQ concluded in 2023 with an equiproportional 50 percent increase in quotas without changes in the Fund's lending capacity, although improving the quality of resources by shifting resources from borrowing arrangements to quota. The agreement for the 16th GRQ also led to the creation of a 25th chair in the Executive Board, enhancing the presence of Sub-Saharan African countries at the Executive Board. This was the first time in IMF history that a quota increase took place without any realignment in quota shares. Unsurprisingly, while the quota increase commanded broad support among the membership, and improved the quality of Fund's resources, there was a sense of frustration by the lack of progress in promoting any realignment. There was additional frustration that there has been little progress on governance reform, and none in the process of selection of the Managing Director. In any case, the sense at the Executive Board and the IMFC was that the Fund should tackle the issue of realignment to ensure its legitimacy, and the 16th GRQ BoG Resolution determined that the Executive Board should "develop, by June 2025, possible approaches as a guide for further quota realignment, including through a new quota formula."

VII. CONCLUSION

There is no doubt that the current distribution of quota shares is at odds with the transformations in the global economy; yet, there has been no agreement on a possible solution. Repeated failures to address these issues will continue to drain the credibility of the Fund, potentially reinforcing the drive for fragmentation, including the construction of alternatives which, inevitably, will be less universal and more closely aligned with different sets of sectional interests. This could contribute to the erosion of the reputation and influence of the IMF and would ultimately damage the interests of the broader membership. A forward-looking strategy aiming at increasing the representation of EMDCs would be more open to accommodating the changing realities of the global economy, and all members, including those of the currently overrepresented economies, have to assess the benefits of this strategy and how they would accept to support it. A backward-looking strategy which would stall the needed rebalancing of the governance of the institution will ultimately serve no one in the long term, given the potential for the IMF to maintain its relevance for large numbers of countries.

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