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Principles for IMF Quota Formula Reform

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The title of this session – Principles for IMF Quota Formula Reform – may not be very appropriate. I have participated in two rounds of quota reviews – the 2008 reform and the 2010 reform – and I can hardly say that this is a discussion based only, or even mainly, on principles. It is largely a matter of ad hoc adjustments, reverse engineering and political understandings.

In any case, there is no doubt that quota redistribution is a central aspect – the central aspect, I would say – of IMF governance reform. Quotas serve multiple functions, as you know. But the link between quotas and access to Fund resources, for instance, is weak and has probably become even weaker in the recent past. On the other hand, the link between quotas and voting power is strong. Quota shares are the main determinant of voting power.

The Board of Governors has requested the Executive Board to complete a comprehensive review of the quota formula by January 2013. This was an important part of the 2010 quota and governance agreement. In Gyeongju, Korea, on the sidelines of a G20 Ministerial meeting, the G-7 and the BRICs came together, in a negotiating session coordinated by the IMF's Managing Director, Dominique Strauss-Kahn. That was in October 2010. On that occasion, we reached an understanding on the main elements of the 2010

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reform. Christine Lagarde was there as Minister of Finance of France. The G-20 plenary then accepted this understanding.

I should stress that Brazil, Russia, India, and China only agreed to the 2010 reform, with its limited progress in terms of overall shift in quota shares and voting power to emerging market and developing countries (EMDCs) in exchange for certain forward-looking commitments, one of which was the comprehensive review of what we see as a severely flawed quota formula.

Indeed, although the 2010 quota increase and redistribution – yet to be implemented, by the way – represents a significant step, it does not solve the legitimacy problem of the Fund. The net shift in quota shares from advanced countries to EMDCs will be a modest 2.8 percentage points, much less than what EMDC chairs had called for (or only 2.1 percentage points if Korea, Singapore, the Czech Republic and a few other countries are classified as advanced).

This is why the forward-looking elements, introduced by the BRICs in Gyeongju, are a key feature of the agreement. During the negotiations in Gyeongju, the BRIC countries expressed the following – and I quote the text that the BRICs distributed during the above-mentioned meeting with the G-7:

> "We are disappointed with the scenarios that have been presented to us. The shift from advanced countries to EMDCs is very small and much less than what we had called for. However, in a spirit of compromise and to move the process forward, we could go along with [the proposed agreement] (…) provided that:
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> 1) The New Arrangements to Borrow are correspondingly rolled back, when the quota increases are effective, preserving the relative shares of the members of NAB.
> 2) The present flawed quota formula which does not reflect the real economic weights of different economies is comprehensively reviewed by January 2013, so that it better reflects the relative economic weight of the IMF members.

> 3) The emerging market and developing countries, including the poorest, still do not have adequate voice and representation in the IMF and hence the next review of IMF quotas should be completed by January 2014."

The communiqués adopted by the G-20 in Gyeongju and in the subsequent G20 Leader's meeting in Seoul incorporated these elements. The IMF's Board of Governor's resolution of December 2010 also included them in somewhat modified language.

That was little more than one year ago. Since then, some progress has been made in implementing the roll-back of the NAB into quotas – in the teeth of determined resistance, I should say, of some countries that wanted to go back on this point of the 2010 agreement. In so far as the quota formula is concerned, some are already working to reinterpret what was agreed. One version, from a representative of a European G20 country, goes something like this: we have, yes, agreed to undertake a comprehensive review of the formula, but this doesn't mean that we have agreed to change it…

Now, this flies in the face of what the G20 committed to do. The agreement explicitly links the comprehensive review of the formula to the goals of better reflecting economic weights and continuing the enhancement of the representation of EMDCs.

We are now only one year away from the January 2013 deadline established by the G20 and the Fund's Board of Governors, but very little has happened. We had only one informal session of the Executive Board, in September of 2011, to discuss a data update and issues related to the quota formula review. The truth is that there is a lot – quite a lot – of foot-dragging on the part of countries – some of them very influential – that are overrepresented and want to delay as much as possible changes in the voting power in the Fund.

The main problem still is the overrepresentation of Europe in the IMF. The 2010 reform did not address this problem sufficiently. The share of the European Union in total IMF quotas will decline only modestly – from 31.9 percent to 30.2 percent. Its share in world GDP in purchasing power terms

(PPP) is about 22 percent considering data through 2009– and falling rapidly. By the way, under the current flawed formula, and strange as it may seem, Europe is underrepresented...

The G20 and the IMFC have recognized that the distribution of quotas should reflect the relative weights of the Fund's members in the world economy, which have changed substantially in view of the strong growth in EMDCs. Relative economic weights of countries can only be measured by their shares in world GDP. Therefore, GDP shares should be the centerpiece of the quota review.

The weight of the GDP variable should be considerably increased (its current weight is 50 percent). The share of GDP-PPP could also be increased from its current 40% of the blended GDP variable. International reserves can be kept with a small weight. A compression factor should also be retained to protect the quota shares of smaller countries.

Variability and openness should be eliminated from the quota formula. Variability seems to make little sense. GDP, rather than quota, has been a better indicator of potential access to Fund financing in recent exceptional access cases. In other words, access measured in relation to GDP seems more stable than access in relation to quota. Openness should also be dropped, among other reasons because of the double counting resulting from the use of a gross measure of openness and the practical infeasibility of measuring this variable on a value added basis.

The quota realignment agreed to in 2010 was based largely on pre-crisis GDP data, covering the period 2006 to 2008. With half of the world economy – the EMDCs – growing much faster than the other half – the advanced economies – the relative weights of countries in the world economy have shifted considerably since then. When the 2010 reform enters into force, it will be already outdated. The same will happen with the next round of quota reform, to be completed by January 2014, if we do not adopt a forward-looking approach.

One should not lose sight of the fact that the world economy is undergoing fundamental changes. The share of EMDCs in world GDP, in PPP terms, was about 40 percent in 2000. It is now over 50 percent and will continue to increase in the coming years. This is the reality to which the Fund has to adjust if it wants to remain relevant and correct its legitimacy deficit.