Report of the Executive Board to the Board of Governors on the Outcome of the Quota Formula Review

I. Introduction

1. In completing the Fourteenth General Review of Quotas and approving the Proposed Amendment on the Reform of the Executive Board, the Board of Governors requested that the Executive Board complete a comprehensive review of the quota formula by January 2013.[1] The Executive Board was also requested to bring forward the timetable for completion of the Fifteenth General Review of Quotas (hereafter the 15th Review) to January 2014. These forward-looking elements were part of an agreed package of 2010 quota and governance reforms. With regard to the 15th Review, Board of Governors' Resolution 66-2 noted that any realignment is expected to result in increases in the quota shares of dynamic economies in line with their relative positions in the world economy, and hence likely in the share of emerging market and developing countries as a whole. It also called for steps to be taken to protect the voice and representation of the poorest members.

2. The Executive Board reaffirmed the urgency of ratifying the 2010 reform, underscoring the importance of quota and governance reform for enhancing the credibility, legitimacy, and effectiveness of the Fund.

3. The Executive Board has held extensive discussions on the quota formula review. The Board met formally to discuss the quota formula review on four occasions during 2012 and has also held two informal meetings. The Board was guided in its work by the views expressed by the International Monetary and Financial Committee (IMFC), and also received inputs from IMFC Deputies, who met in March and September 2012, and January 2013, to discuss the review and support consensus building among the membership.

4. Important progress has been made in identifying key elements that could form the basis for a final agreement on a new quota formula. It was agreed that achieving broad consensus on a new quota formula will best be done in the context of the 15th Review rather than on a stand-alone basis. Thus, the discussions on this issue will be integrated and move in parallel with the discussion on the 15th Review.

5. This report responds to the Board of Governors' request and summarizes the outcome of the quota formula review. It identifies areas of common ground as well as areas where views differ among Board members and further discussions are needed. It is recognized that views on the key elements of the quota formula have evolved during the review and will

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[1] See *IMF Quota and Governance Reform—Elements of an Agreement—Report of the Executive Board to the Board of Governors*, and Board of Governors' Resolution 66-2, adopted December 15, 2010.

continue to evolve as further work is undertaken as part of the 15th Review and new data become available. It is further recognized that all these elements are inter-connected and that eventual agreement will require an integrated package that reflects a spirit of cooperation and compromise across the membership.

II. Outcome of the Quota Formula Review

6. The Executive Board's discussions covered a wide range of issues. These included, inter alia, the principles that should guide the review, the role and measurement of the existing quota formula variables, the relative weights of the variables, the scope for further simplifying the formula, and the merits of adding new variables. The discussions were informed by a wide range of simulations of alternative possible reforms and by extensive technical work prepared by staff, including on how to capture potential need for Fund resources, openness and interconnectedness, alternative measures of financial openness, and measuring members' financial contributions to the Fund.[2]

7. The Executive Board took note of the results of updating the quota data through 2010. These showed that the aggregate calculated quota share of emerging market and developing countries had increased by 7.7 percentage points in the 5-year period since 2005, the data used for the 2008 reform. Some saw this shift as providing evidence that the current formula adequately captures dynamic developments in the world economy and is not in need of radical reform. Others considered that the formula remains seriously flawed, producing results that do not adequately reflect members' relative positions in the global economy, including the increased importance of emerging market and developing countries.[3]

8. It was agreed that the principles that underpinned the 2008 reform remained valid as a guide for the quota formula review. Thus, the formula should be simple and transparent, consistent with the multiple roles of quotas,[4] produce results that are broadly acceptable to the membership, and be feasible to implement statistically based on timely, high quality and widely available data.

9. It was agreed that GDP should remain the most important variable, with the largest weight in the formula and scope to further increase its weight. GDP is generally seen as the

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[2] Public Information Notices for all Executive Board discussions and the background papers prepared by staff are available on the Fund's external website at www.imf.org.

[3] The current formula, agreed in 2008, includes four variables: GDP (consisting of market GDP with a 30 percent weight and PPP GDP with a 20 percent weight), openness (30 percent weight), variability (15 percent weight), and reserves (5 percent weight). A compression factor of 0.95 is applied to the weighted sum of these variables.

[4] These include their key role in determining the Fund's financial resources, their role in decisions on members' access to Fund resources, their role in determining members' shares in a general allocation of SDRs, and their close link with members' voting rights.

most comprehensive measure of economic size. Considerable support was expressed for increasing its weight, particularly if variability is dropped (see below), but others preferred to either keep the current weight or maintain it relative to that of openness.

10. Consideration will be given to whether or not the weight of PPP GDP in the GDP blend variable should be adjusted. Two broad views were expressed in the discussions under the review. One view was to retain the current blend, noting that it had been a difficult compromise that should not be reopened. Some who supported this view nevertheless continued to see various problems with using PPP GDP. Others favored increasing the weight of PPP GDP in the blend variable, noting that these data are widely used and that this would increase the share of emerging market and developing countries, including that of low-income countries.

11. It was agreed that openness should continue to play an important role in the formula, and concerns regarding this variable need to be thoroughly examined and addressed. Openness seeks to capture members' integration into the world economy. One view was to keep the openness variable as currently defined, with some favoring increasing its weight if variability is dropped. Another view was that the current measure is seriously flawed reflecting both conceptual and measurement issues, including its reliance on gross flows and given the challenges posed by intra-currency union trade. Several options were examined to bridge these differences, including the possible use of a cap on openness in relation to GDP, but views remained divided. Some also favored increasing the weight of financial openness, but this did not attract sufficient support.

12. There was considerable support for dropping variability from the formula. Extensive consideration was given to the role of variability, which seeks to capture members' potential need for Fund resources. The Executive Board took note of the staff's finding that there is little empirical evidence of a relationship between variability and actual demand for Fund resources and the difficulties of identifying a superior measure. Some conditioned their support for dropping variability on other elements of an integrated reform package, including how its weight is reallocated and the adequacy of measures to protect the poorest members. Some continued to see a role for variability.

13. There was considerable support for retaining reserves with its current weight. The reserves variable provides an indicator of members' financial strength and ability to contribute to the Fund's finances. Views were also expressed in favor of either increasing its weight to better capture members' ability to contribute to global safety nets, or eliminating it given the concern that it could reward excessive reserve accumulation.

14. Options were considered for including a new measure of financial contributions in the formula, with arguments made for and against such a reform. Views diverged on the merits of such an approach. It was agreed to consider whether and how to take into account very

significant voluntary financial contributions through ad hoc adjustments as part of the 15th Review.

15. Consideration will be given to whether or not the current level of compression should be adjusted. It was generally agreed that the quota formula should continue to include a compression factor to help moderate the influence of size in the quota formula. One view was to retain the current compression factor, noting that it had been a difficult compromise that should not be reopened. Others favored increasing the level of compression to give greater voice to small members, as well as to emerging market and developing countries as a group.

16. It was agreed that measures should be taken to protect the voice and representation of the poorest members. Considerable support was expressed for addressing this issue as part of the 15th Review.

17. In sum, the Executive Board's discussions under the review have provided important building blocks for agreement on a new quota formula that better reflects members' relative positions in the global economy. The outcome of this comprehensive review of the quota formula will form a good basis for the Executive Board to agree on a new quota formula as part of its work on the 15th Review, and building the needed consensus among the membership on a reform package that can garner the broadest possible support.