BRICS and IMF: why the IMF quota formula review still matters

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Thank you very much for this opportunity to present our views on the ways of ensuring BRICS interests in the IMF! Actually, it is a view from outside but I hope it will be useful. My presentation is based on two research papers prepared by the Russian Institute for Strategic Studies earlier this year. The first one presents the views of BRICS' experts on further IMF reform. The second highlights the issues of the IMF quota formula review and our assessment of its elements.

But first of all let me make it clear why the IMF is so important. First and foremost, it is the only international financial institution that (I hope) has enough resources – actually, about 1 trillion dollars – to support countries impacted by crisis. Moreover, the IMF is the largest center for providing policy advice on most of the economic and financial issues, addressing not only G-20 countries, but the whole international community as well.

That is why our countries recognize the IMF as the center of the Global financial safety net. At the same time, this poses a question of further IMF governance reform and ensuring stronger voice for our countries in it. As our poll showed, BRICS experts pointed out the importance of such topics as a review of the list of issues requiring the 85per cent majority, a member-country's right to veto the IMF's decisions solely, procedure of executive directors' elections and so on. But the main question remains the same – redistribution of quotas.

Today, despite the adoption of so-called "package of 2010 reform", this issue still has not been solved. The BRICS quota increased from 11.5 per cent to only 14.7 per cent, which as you may see on the Fig. 1 does not correspond to the economic weight of our countries that together constitute about 23 per cent of world GDP at market price and more than 30 per cent at purchasing power parity.

So the BRICS are among the group of underrepresented members of the IMF, while overrepresented countries are mostly European states.

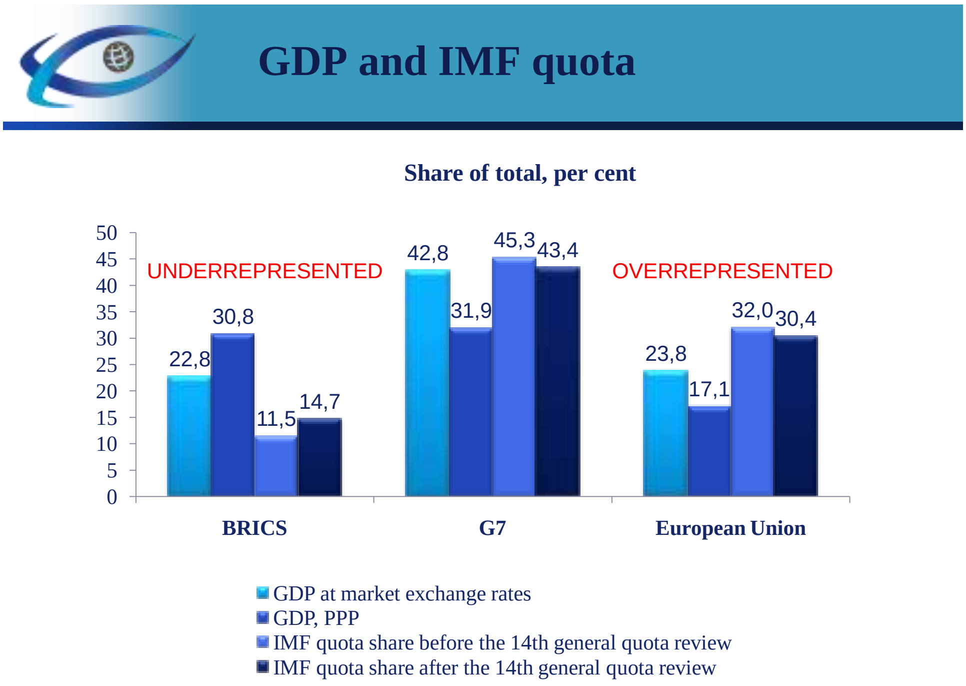

Fig. 1

To this end I believe that in the medium term, a “window of opportunities” is connected solely with the review of the quota formula. Let me remind that this issue (along with the changes included in the package of 2010 reform) was agreed back in Seoul. However, its implementation has begun only now and there are a lot of challenges on this way.

The latest decisions of the IMF expose the unwillingness of its authorities to protect the interests of developing economies. To begin with, this is reflected by the recent decision «to reset the timetable for completing the 15th Review by 2019», which was presented just a month after the G-20 under the chairmanship of China had declared its readiness to ensure the review completion by 2017.

Moreover, the BRICS countries face several other challenges. One of them is a drift from the aim, initially set in Seoul, of «Continuing the dynamic process aimed at enhancing the voice and representation of emerging market and developing countries in the IMF». This aim is currently presented by the IMF and its largest shareholders as we can see on the Fig. 2 as “increase in the quota shares of dynamic economies … and hence likely in the share of emerging market and developing countries”. Furthermore, in a recent statement of Germany, next G-20 chairman, it was put only as a «shift to dynamic countries». However, the term “dynamic economies or countries” is still not clarified – it could be, for instance, USA, Australia or some other state.

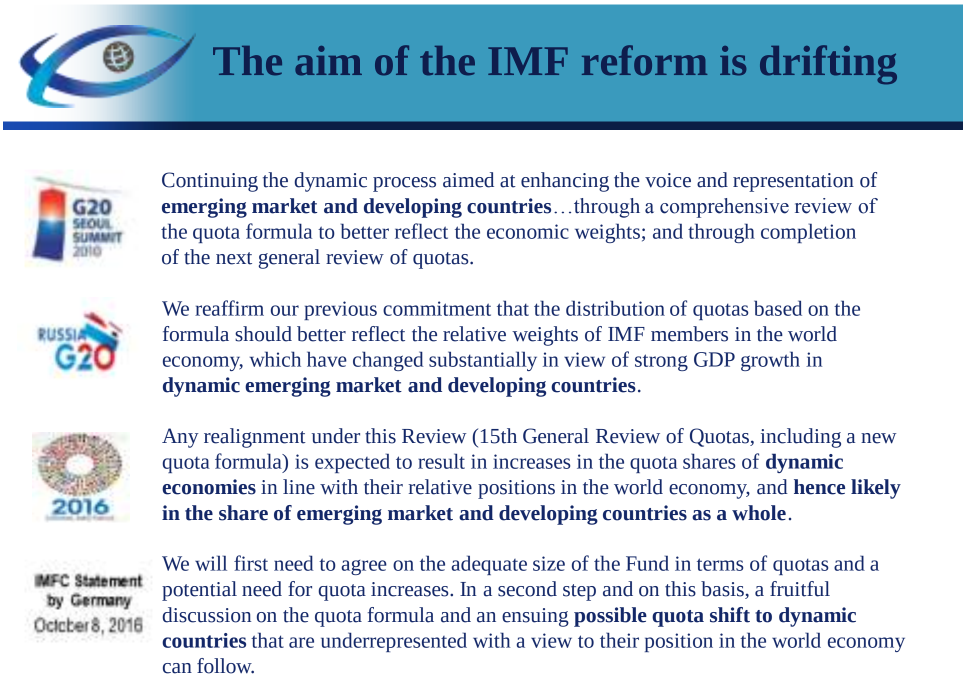

Fig. 2

Out-of-date classification of advanced and developing countries used by the IMF is also worth mentioning. The fact is that this classification gives a misleading impression on quotas distribution, since according to it, some countries of Europe, as well as Singapore and South Korea belong to developing economies.

One more challenge can be described as willingness of some countries to include the so called «Voluntary Financial Contributions» in the quota calculations. Obviously, these contributions do not relate to the role of the IMF member-states in the world economy, consequently their main function, to my mind, is to slow down the process of shifting of shares in the IMF to developing economies, since their distribution (Fig. 3) is in favor of advanced economies.

The overwhelming predominance of western researches represents one more issue of great importance. As a result, works of only Western specialists serve as a basis for the discussion. Such domination allows advanced economies to impose on the developing countries the usage of the quota formula that meets their interests.

Voluntary Financial Contributions

INTERNATIONAL MONETARY FUND

QUOTAS—DATA UPDATE AND SIMULATIONS

September 2016

Annex IV. Voluntary Financial Contributions

Table IV.1. Financial Contributions to the Fund: Selected Indicators

	14th Review Quota Share	Share in Financial Contributions to NAB with Rollback 1/	Bilateral Borrowing Agreements 2/	PRGT Loans 3/	PRGT Subsidies 4/	Capacity Development 5/
Advanced Economies	57.6	75.0	68.4	91.4	80.2	84.8
Emerging Market and Developing Count	42.4	25.0	31.6	8.6	19.8	15.2

Fig. 3

That is the reason for the BRICS expert community to pay more attention to this aspect. Fundamental research of the issue carried out by experts from BRICS will be an important instrument for the stage-by-stage changes. Moreover, an open discussion would help to develop a consolidated position and attract other developing countries to the BRICS initiatives on this issue.

And that was also the reason for us in the Russian Institute for Strategic Studies to look at how a fair distribution of quotas and votes in the IMF could be achieved. The calculations we have done showed that even small changes in the formula are enough to set the quotas of developing countries to their real weight in the world economy.

But it would be very difficult to bring these changes into reality. Let’s have a look at the current formula at the Fig. 4. It has two variables: GDP and reserves that are clear and reasonable. While two others (variability and openness) seem to be rather questionable. Moreover, both of these variables have extremely high correlation with GDP. But their usage is usually justified by the necessity to take vulnerability factor into account.

Current IMF quota formula

$$\mathbf{CQS = (0.5*Y + 0.3*\cancel{O} + 0.15*\cancel{V} + 0.05*R)^k}$$

where:

CQS = calculated quota share;
Y = a blend of GDP converted at market exchange rates and PPP exchange rates averaged over a three year period. The weights of market-based and PPP GDP are 0.60 and 0.40, respectively;
O = openness that is the annual average of the sum of current payments and current receipts (goods, services, income, and transfers) for a five year period;
V = variability of current receipts and net capital flows (measured as the standard deviation from a centered three-year trend over a thirteen year period);
R = twelve month average over one year of official reserves (foreign exchange, SDR holdings, reserve position in the Fund, and monetary gold);
k = a compression factor of 0.95.

Correlation between GDP, openness and variability

countries	openness	variability
All IMF member countries	0,93	0,94
Developed countries	0,91	0,97
Developing countries	0,96	0,91

Fig. 4

In our research we agreed with the assumption strongly supported by Western experts that upon the calculation of quotas, “vulnerabilities” should be considered along with GDP. Such variable means a country’s vulnerability to global and external financial disturbances. But which variable should be chosen?

The proposed quota formula

CQS=α*GDP + β*FS, provided that α + β=1

where:

GDP = GDP, calculated as γ* GDP (PPP) + δ*GDP at market exchange rates (γ+δ=1);
FS = financial sustainability variable, calculated as κ***reserves** + λ*X/**debt** (κ+ λ=1).

As X we used the following two variables: GDP and openness.

Correlation between GDP, reserves and debt variables

countries	reserves	debt*
All IMF member countries	0,62	-0,07/-0,08
Developed countries	0,27	-0,25/-0,13
Developing countries	0,94	0,008/-0,03

(*depending on the selected debt variable (GDP/debt; openness/debt)

Fig. 5

In our opinion, vulnerability of the economy may be best evaluated under the condition of increasing the weight of international reserves as well as adding the variable of public debt reflecting the long-term results of the country's budgetary policy.

In this case, the new formula can be showed as follows: please, have a look at Fig. 5. On the Fig 6 you can see the result of our calculations. Actually, we tried to look at how different variables for debt element and different weights influence the result. We found out that the use of proposed formula would lead to a more fair distribution of quotas.

Key quota share estimates (%)

Quota formula variables and their weights	Developed countries	G7	Developing countries	BRICS
GDP (55 per cent), openness (20 per cent), debt (15 per cent), reserves (10 per cent)	50.0	32.4	50.0	21.7
GDP (55 per cent), openness (25 per cent), debt (15 per cent), reserves (5 per cent)	49.6	31.8	50.4	19.8
GDP blended (60/40), openness (20 per cent), reserves (10 per cent), debt (5 per cent)	49	32.7	51.0	22.3
GDP (50 per cent), openness (30 per cent), debt (15 per cent), reserves (5 per cent)	46.8	30.0	53.2	18.9
GDP blended (60/40), reserves (10 per cent), debt (5 per cent)	46.3	33.1	53.7	23.7
GDP (80 per cent), debt (15 per cent), reserves (5 per cent)	43.5	30.8	56.5	20.9
GDP (70 per cent), reserves (15 per cent), debt (15 per cent)	41.4	28.5	58.6	22.6

Fig. 6

I should note that the presented ideas (especially with regard to the formula's variables) should be mostly considered as a suggestion for further research and discussion. I think that there are also other variables that could be used in the quota formula and other distribution of the weights among them as you may see on the Fig. 7. That is why, the main idea of my presentation is the necessity to continue research on this and similar practical issues by the expert community of our countries. This work is really essential to protect the interests of BRICS. On the basis of the conducted research we could formulate a unified position of the BRICS member-states on the issues of the formula review, fair quotas distribution and further IMF governance reform, that subsequently could be supported by other developing countries.

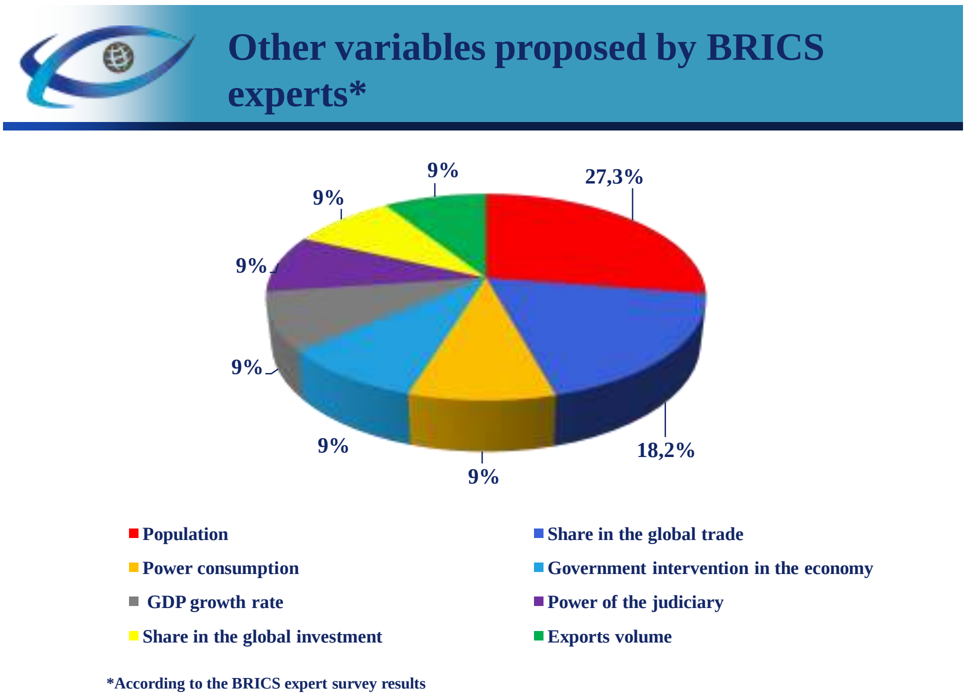

Fig. 7

And my last but not the least point is that basing on the European experience we should establish an informal committee of our IMF Executive Directors, say BRICS-IMF group, to facilitate an exchange of views between them and to better coordinate BRICS positions within the IMF. And in particular that BRICS-IMF group should present the unified position of the BRICS nations at one of the IMF and World Bank meetings.

In that case we should be able to have a unified position and one voice in the IMF.

Thank you very much for your attention!