T20 Policy Brief

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Task Force 03

REFORMING THE INTERNATIONAL FINANCIAL ARCHITECTURE

Reimagining the IMF's Quota System and Representation in Africa's Interest

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Abstract

The IMF functioning as the global "lender of last resort," utilizes a quota system pivotal for member countries, determining financial commitments, voting power, assistance access, and Special Drawing Rights (SDRs) allocation. Established in 1944, the initial historical considerations evolved into a formula based on economic size, openness, variability, and international reserves.

Despite periodic reviews, the current formula perpetuates imbalances, favoring high-income countries. Attempts to address this, such as the 14th Review in 2010 which doubled quotas and reallocated shares, and the 2023 16th Review, which proposed a 50% increase, have not rectified the skewed distribution. Overall, this limits the voice and emergency support access for low- and middle-income countries, especially in Africa.

The persistent inequity in the Africa region's allocation since the IMF's inception raises concerns about the fairness of the existing quota system. This paper advocates for larger quota shares for African countries, driven by their financial needs, vulnerability to external shocks, and anticipation of increased emergency financial requirements due to climate change.

The upcoming 2025 17th General Review of Quotas provides an opportune moment to address these issues. Reforming the deficient quota formula, rather than a simple increase, emerges as a more equitable solution. Doubling African quotas to 10% and redistributing non-African quotas could provide an extra 24.6 billion SDRs, augmenting Africa's decision-making power.

This paper emphasizes the urgency of rectifying deficiencies in the IMF quota formula to break the cycle where African countries, locked into seeking limited resources, struggle to build resilience. The impending review process offers an opportunity for member countries, particularly within the African Union, to advocate for a fairer quota system reflecting the diverse needs and vulnerabilities of all IMF member states.

Diagnosis of the Issue

The International Monetary Fund (IMF), known as the world's "lender of last resort", employs a system of quotas that serves four essential functions for its member countries.[1] The quotas determine: financial commitments (e.g., for increasing the IMF's capital); voting power (for example on decisions to provide emergency finance to countries in times of need); access to financial assistance (quotas create limits on what countries can borrow easily from the IMF at times of need); the allocation of Special Drawing Rights (SDRs).

Quotas were agreed at the creation of the IMF in 1944, and in those discussions, different member states argued for higher quota shares.[2] For example, the UK argued for a quota share that reflected its trade with its then colonies in its empire. The US argued that its large economic size should be taken into account. France argued that the population of its colonies should affect its quota as well. Over time, a "formula" emerged, which is now generally used as a means to determine and adjust quota shares of IMF member states as they join, grow and develop. Today's formula has four key elements:

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[1] "IMF Quotas," International Monetary Fund, December 19, 2023. https://www.imf.org/en/About/Factsheets/Sheets/2022/IMF-Quotas.

[2] Altaian, Oscar L. "Quotas in the International Monetary Fund," IMF eLibrary, 1956. https://www.elibrary.imf.org/view/journals/024/1956/002/article-A001-en.xml#:~:text=The%20quotas%20of%20the%20original,process%20of%20negotiation%20and%20compromise.

- An “economic size” variable (GDP), such that bigger economies get a bigger share – on the basis that if their economies suffer, they may need to draw on relatively more resources from the IMF (accounts for 50% of the quota determination);
- An "openness" variable, such that countries that are more open to the world and therefore global shocks get more resources from the IMF (30% of the quota determination);
- A “variability" variable such that countries that have more volatile or vulnerable economic features that make them more susceptible to balance of payments shocks (e.g., they have high flows of foreign investment or are more reliant on exports) get more access to IMF resources (15% of the quota determination)
- An "international reserves" variable to reflect that those countries with higher reserves of foreign exchange, gold or SDRs, get more access to IMF resources (5% of the quota determination).

It is obvious that as a result of this formula, high-income countries end up holding significantly larger quotas, which not only limits the voice and decision-making power of low-income countries but also limits their access to emergency IMF support. This is despite the fact that history has shown that low and middle-income countries are more likely to need "lender of last resort" support from the IMF than their high-income counterparts.[3]

[3] “SDR-Tracker,” International Monetary Fund, February 24, 2022. https://www.imf.org/en/Topics/special-drawing-right/SDR-Tracker.

However, helpfully, the IMF quota system is regularly reviewed. For instance, with the rise of emerging market economies, the IMF's 14th General Review of Quotas, completed in 2010 and implemented in 2016, aimed to enhance their decision-making power and access to IMF resources.[4] This was achieved by a combination of roughly doubling all quotas of IMF member-states as well as making changes to the quota formula to shift 6% quota shares from what were perceived as "overrepresented" members to those underrepresented—to reflect changes in the global economy.

In contrast, the next (15th) General Review of Quotas, concluded in 2020, did not involve any changes to quotas but provided guidance for the recently concluded 16th Review.[5] In the most recent review (16th) in December 2023, no changes were made to the quota formula and therefore distribution, but the IMF did agree that all quotas of member countries should increase proportionally by 50%.[6]

[4] "Press Release: Historic Quota and Governance Reforms Become Effective," International Monetary Fund, January 27, 2016. https://www.imf.org/en/News/Articles/2015/09/14/01/49/pr1625a.

[5] "IMF Board of Governors Approves a Resolution on Quota Reviews," International Monetary Fund, February 13, 2020. https://www.imf.org/en/News/Articles/2020/02/13/pr2050-imf-board-of-governors-approves-a-resolution-on-quota-reviews.

[6] "IMF Board of Governors Approves Quota Increase under 16th General Review Quotas," International Monetary Fund, December 18, 2023. https://www.imf.org/en/News/Articles/2023/12/18/pr23459-imf-board-governors-approves-quota-increase-under-16th-general-review-quotas.

Today, after all these changes, the US with 17% of the total quotas remains the largest IMF shareholder among the G20, continuing to grant it effective veto power in any discussions involving changes to the quota formula (see Figure 1 below). G20 member-states, excluding South Africa, the European Union (EU), and African Union (AU), collectively possess 71% of total IMF quotas.[7]

Meanwhile, AU member-states collectively possess 5.2% of the total quotas, which is equivalent to just 29.7% of the quota share of the US. Within these African member-states, South Africa holds the largest share (0.64%), followed by Nigeria (0.52%), Egypt (0.43%), and Algeria (0.41%). That means that 39 African countries each represent less than 0.1% of overall IMF quotas. To put this in context differently, a single country like Germany has around the same number of quotas as the entire African continent. The African region has had this kind of limited allocation from the very beginning. Only four African countries were founding members of the IMF out of a total 44 countries in 1944. Of those African founding members, South Africa, Egypt and Ethiopia now have fewer shares than they did initially. African shares have not been protected over the last 80 years.

[7] "IMF Members' Quotas and Voting Power, and IMF Board of Governors," International Monetary Fund, July 31, 2021. https://www.imf.org/en/About/executive-board/members-quotas.

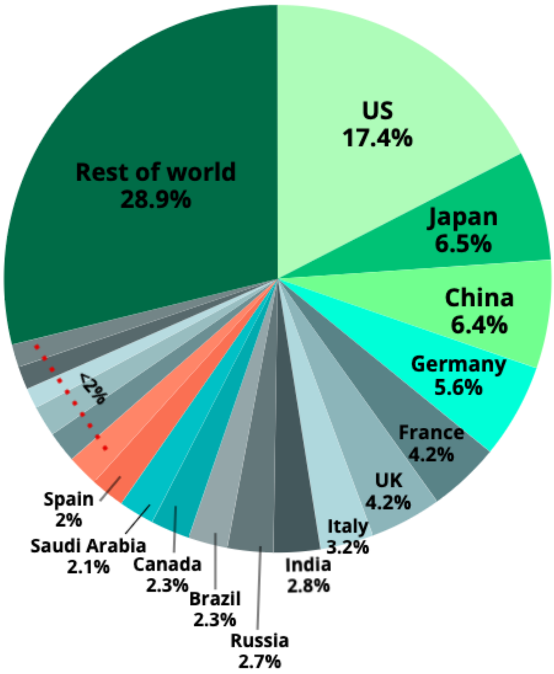

FIGURE 1. Quotas of different IMF member states as % of total

A further consequence of the IMF's present formula is the distribution of power. Since the IMF's inception, there have traditionally only been two African IMF Executive Directors (EDs). Whereas a third recently was added at the 2023 IMF Annual Meetings, this was not accompanied by an increase in Africa's decision-making power. In other words, adding a third Executive Director for Africa without a corresponding increase in voting power means that Africa got more voice—a welcome development—but no change in bite i.e., no change in its decision-making power.

The question therefore is, should African countries get larger quota shares? If so, what quota volume and share would be in Africa's interest to aim for? And how could this be achieved? The case for a larger quota for African countries is three-fold, and very strong, beyond the stark inequities already set out above:

- **African countries have significant financial needs for development**, but their economic size (especially individually) is insufficient to ever raise sufficient finance on their own (especially for infrastructure spending which is extremely lacking) and provide enough resources to build up financial reserves;

- **African countries have demonstrated over time their vulnerability to external shocks**, especially due to their long-standing, low-value and commodity-based economic structure, a structural vulnerability that is not sufficiently captured by the quota formula;
- Going forwards, **African countries can be expected to need more emergency financial resources** due to high climate change risk and vulnerability.

Overall, under the existing quota formula, African countries are effectively locked into a vicious cycle whereby they regularly need to seek resources from the IMF, but those resources are always too limited to enable any real change that will build resilience to shocks that the IMF is ostensibly meant to help deal with.

The IMF Board of Governors will engage in the 17th General Review of Quotas by June 2025.[8] Developing and sharing an African view of quota reform through the G20 could be very useful to this process.

These changes are in the IMF's own interest – so that it becomes more credible and increases its own capacity to fulfill its lender of last resort mandate. Reform of the IMF Quota system in Africa's interest is consistent with the G20's stated goal for a balanced

[8] "Sixteenth General Review of Quotas-Report to the Board of Governors and Proposed Resolution, and Proposed Decision to Extend the Deadline for a Review of the Borrowing Guidelines," International Monetary Fund, December 18, 2023. https://www.imf.org/en/Publications/Policy-Papers/Issues/2023/12/18/Sixteenth-General-Review-of-Quotas-Report-to-the-Board-of-Governors-and-Proposed-Resolution-542596.

quota reform for the IMF towards emerging market and developing country economies.[9] Moreover, as demonstrated by the different scenarios laid out here, the G20 member countries can achieve this goal at minimal cost to themselves but with much benefit for Africa and the world at large.

[9] Kring, William N. "Towards a Balanced Quota Reform at the IMF: Global Development Policy Center," Global Development Policy Center, 2023. https://www.bu.edu/gdp/2023/06/28/towards-a-balanced-quota-reform-at-the-imf/#:~:text=The%20authors%20argue%20a%20renewed,risks%20to%20global%20financial%20stability.

Recommendations and Scenarios

The deficiencies in the IMF quota formula produce a skewed quota distribution that undermines the IMF's capacity to meet the needs of its member states, especially low- and middle-income countries, and particularly AU member states. But what kind of formula adjustment might be better for Africa? To explore and induce this it is first crucial to review what kind of overall allocation adjustment would be in African interests.

Recommendation 1: Redistribute Quotas to increase Africa's overall share

First, it is important to clarify that in most cases redistribution of quotas to increase Africa's overall share leads to a higher quota for Africa than simply increasing quotas for all countries. This is illustrated in Figure 2 below. For instance, with a straightforward 50% increase in IMF quotas, African countries would gain extra quotas worth 18.5 billion SDRs, with no change to their collective power in the institution. However, if African quotas are doubled (i.e., from 5% to 10%) and quotas of non-African countries redistributed to compensate for this, Africa gets extra quotas worth 36.9 billion SDRs, and increases its relative voice and decision-making power in the IMF. A similar result - i.e., an increase in Africa's quota share as well as an increase in its voice and decision-making power – would obtain in the scenario where there is a 50% overall quota increase accompanied by a doubling of Africa's quota share.

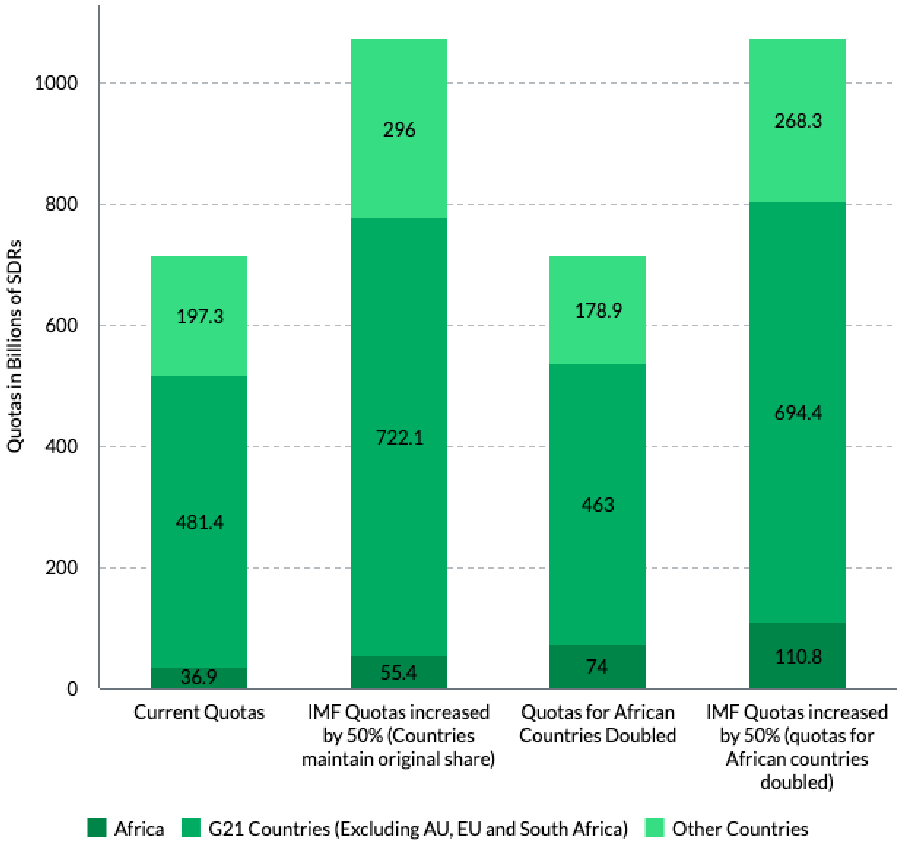

FIGURE 2. Impact of changing IMF quotas for African countries

There is a plethora of means to "redistribute" quota shares from non-African to African countries. Below we model scenarios to double Africa's share to 10%.

Recommendation 1a: Redistribute Quotas evenly across non-African countries

Quotas could be evenly redistributed across non-African countries. This would result in a reduction of 271.5 million SDRs for each non-African country. The collective share of G20 countries would decrease by 1.52%, amounting to a total reduction of SDR 4.95 billion. However, this would also lead some countries to have negative SDRs (especially small non-African countries such as islands).

Recommendation 1b: Equally redistribute Quotas of only G20 members[10] to increase Africa's overall share

Quotas of only G20 member countries, excluding AU member-states, could be equally redistributed to African countries. Consequently, the quotas for G20 countries would decrease by 11.5%, with each country's quota diminishing by SDR 2.04 billion.

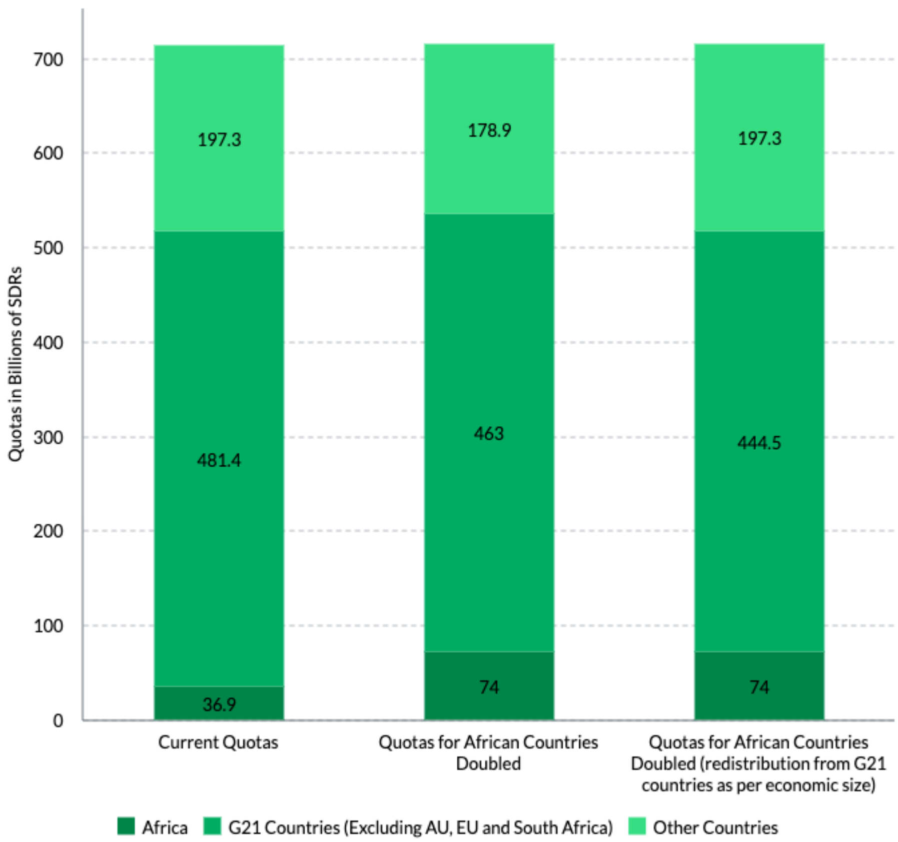

FIGURE 3. Scenarios for redistributing Quotas to Africa

[10] Excluding AU Member States

Recommendation 1c: Redistribute Quotas of only G20 members proportionately to increase Africa's overall share

Quotas of G20 members only could be redistributed, but this time in accordance with their existing quota proportions, i.e., more over-represented countries reallocate more quota shares. The US' quota share would decrease from 17.4% to 16.5%; Japan's share decreases from 6.5% to 6.1%, and China's from 6.4% to 6.05%. Germany, the largest economy in Europe, would have its share fall from 5.6% to 5.3%; Russia's share falls from 2.7% to 2.6%, and Brazil's from 2.3% to 2.2%. Meanwhile, relatively smaller economies such as Argentina, Indonesia, and Turkey also seeing a decrease, but to a lesser extent (Figure 4).

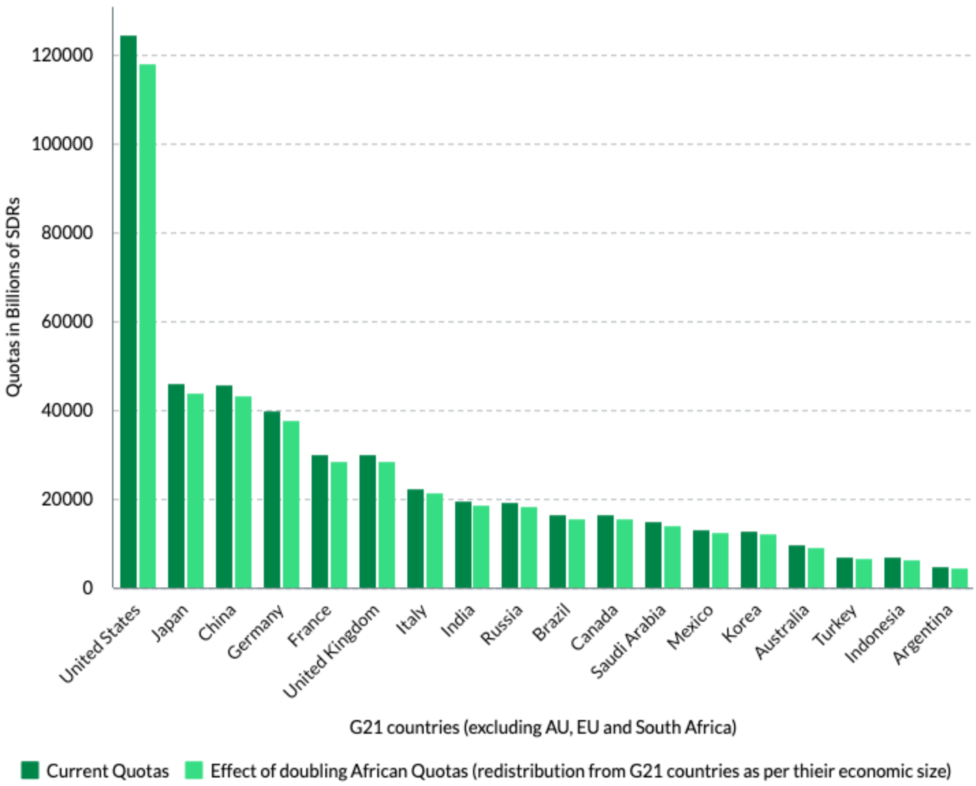

FIGURE 4. Impact of a proportional redistribution of G20 quotas to Africa (Scenario C)

For African countries, the benefits of doubling their quota share outweigh the cost of increased contributions to the IMF as a result of a higher quota share. Within these different scenarios, it would be possible to accommodate any concerns of other low- and middle-income countries about their own voice and power in the IMF, and the G20 itself can make decisions amongst themselves on how to manage redistribution. **In our view, the third scenario (recommendation 1c) is the most viable and easiest for G20 members to execute.**

Recommendation 2: Adjust the 'Variability' variable in the IMF Quota formula to favor low-and middle-income countries

While the 'variability' variable was originally specified to capture members' potential need for IMF resources, in its current form, advanced economies have around 60% of the variable which translates to nine percentage points in the quota formula.[11] However, the IMF's 15th General Review of Quotas found no significant relationship between "variability" and member-states' actual or potential demand for IMF resources.[12] Thus, the variability variable should aim to favor low- and low-middle-income countries that are significantly more vulnerable to exogenous shocks, balance of payments shocks and, as a result, have greater need for IMF resources. Alternate approaches could, for instance, include using the rate of SDR utilization in the past.

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[11] De Leon, Ernando S. "The IMF Quota Formula Review," International Monetary Fund, 2011. https://www.bsp.gov.ph/Media_And_Research/Publications/BS11_A4.pdf.

[12] "Fifteenth General Review of Quotas—Further Considerations," International Monetary Fund, 2021. https://www.imf.org/-/media/Files/Publications/PP/2021/English/PPEA2021009.ashx.

The "openness" variable also needs review – as it biases the quota distribution in favor of countries that in volume terms (not relative terms) are more engaged in international trade and financial activities, which tend to be advanced economies, and is measured in a gross form rather than value-added basis, leading to distortions due to the double counting of cross border flows. Adjusted Terms of Trade could, for instance, be used instead, thus favoring countries that have more vulnerability to shocks because they have worse terms of trade.

This analysis provides a strong, theoretical basis for a quota formula that favors Africa and is more reflective of the IMF's role as the global lender of last resort.

Recommendation 3: Increase Africa's Decision-making Power in the IMF

IMF quota reform should facilitate stronger decision-making power for Africa to tackle challenges such as staff diversity and representation within the IMF. Currently, African countries have very little decision-making power due to the quota structure as reflected in IMF board representation which is important for several reasons.

The IMF board, for instance:

- Oversees and approves decisions related to the IMF's quotas and overall capital base;
- Oversees and approves disbursements of IMF resources;
- Oversees and approves the conditions under which those disbursements are made;
- Oversees and approves the IMF's approach to interest rates and debt servicing;
- Oversees and approves the analytical work of the IMF;
- Oversees and approves the IMF's approach to diversity and staffing – for instance, whether the IMF's president, senior leadership, staff and consultants at all levels reflect the regions they serve or their shareholders; and much more.

Whereas African countries are directly affected by the decisions of the IMF Executive Board on these crucial matters, Africa does not have sufficient power to meaningfully influence the outcomes of these decisions.

Conclusion

The proposed changes will increase the IMF's credibility and its capacity as the lender of last resort. These changes also align with the G20's aspiration for a balanced IMF quota reform. Furthermore, the proposed changes can accommodate any concerns of other low- and middle-income countries about their own voice and power in the IMF. Finally, these changes can all be undertaken at minimal cost to the G20 countries but with great benefit to Africa and the world at large.

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