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A European Voice at the IMF

The IMF membership quotas are to be re-examined in early 2003, which could allow member countries to reconsider the representation of the European Union. At present, the breakdown of constituencies dilutes Europe's voting power, despite efforts made to achieve coordination. Various scenarios are possible. If the European countries are grouped together into a constituency, then their vote would weigh very heavily, which is unlikely to be acceptable to third countries. Bringing together EU members within a single seat would raise a number of legal problems, but would have the advantage of reconciling both the value of having a single seat and reducing the share of European quotas, thus leaving more place to the developing countries. The size of the Union (12 to 25 countries) has a considerable impact on the calculations of the Union's single seat quotas and the implicit quotas of each member country. The political negotiations which may more or less set aside quotas calculated on the basis of theoretical formulae also affect the results.

Voting Rights at the IMF

The question of country representation in international institutions — and especially in the International Monetary Fund — constitutes a major issue in the reform of world governance[1]. The IMF is governed by two decision-making bodies: the Board of Governors, which brings together 184 representatives from member countries once per year; and the Executive Board, whose 24 Executive Directors take concrete decisions several times a week (see Box 1). While there is little formal voting on the latter Board, the relative power of member countries in both bodies depends on the voting rights they have been attributed, rights which are nearly proportional to the national quotas (the fixed, uniform voting rights are very limited)[2]. The industrialised countries hold 60% of the quotas, the United States alone accounting for 17%. This is almost as much as the developing Asian countries and Latin America combined, and enough to block all decisions requiring an 85% majority. The quotas fix, first and foremost, the contribution of each country to the IMF's capital. At the Bretton Woods conference which created the IMF in 1944, it was decided to allocate quotas as a function of member countries' capacity to contribute to the fund, and to give the Allies of World War II the lion's share[3] of quotas. The industrialised countries (as defined today) thus acquired 64% of the quotas, while the USSR and China also received significant shares. However, the quotas also determine the level of credit that each country may obtain from the IMF, under the Fund's normal arrangements[4]. From this point of view, the dominant weight of the industrialised countries reflects poorly the potential needs of member countries, which are linked more to their openness and the instability of the various components of their balance of payments. The quotas were thus redistributed in 1962-63, and again in 1983, within the framework of the five-year reviews set out in the Articles of the IMF. Similarly, the quotas of specific countries have been revised from time to time: the latest example being the increase of China's quota in February 2001, following Hong-Kong's transfer of sovereignty. The attribution of quotas currently draws on five mathematical formulae, which link a country's quota to a number of

1. See P. Jacquet, J. Pisani-Ferry & L. Tubiana (2002), *Gouvernance mondiale*, Rapport du CAE No 37, and especially the contribution by P. Guillaumont & S. Guillaumont-Jeanneney.
2. Each Member State is endowed with 250 voting rights for every STR 100000 quota. Even for the smallest country in terms of the quota (Palau), the fixed part of the voting right is almost negligible (7.5% of Polau's voting right).
3. Raymond Mikesell was given the responsibility of fixing the first formula for calculating quotas, a process he has described: "White called me to his office and asked that I prepare a formula for the... quotas that would be based on the members' gold and dollar holdings, national incomes, and foreign trade. He gave no instructions on the weights to be used, but I was to give the United States a quota of approximately $2.9billion; the United Kingdom (including its colonies), about half the US quota; the Soviet Union an amount just under that of the United Kingdom; and China somewhat less. White's major concern was that our military allies (President Roosevelt's Big Four) should have the largest quotas, with a ranking on which the President and the Secretary of State had agreed". (R. Mikesell (1994), "The Bretton Woods Debates: a Memoir", *Princeton Essays in International Finance*, No 192).
4. Under normal arrangements a member country can currently borrow up to 100 percent of its quota annually and 300 percent cumulatively. This is not an absolute limit, however, as the Supplemental Reserve Facility and Contingent Credit Line can provide extra finance.

Box 1 — The IMF's Decision-Making Process

- The *Board of Governors* brings together representatives (the Minister of Finance or Governor of the Central Bank, depending on the country) of the 184 member countries. Given the large number of Governors, the nature of annual meeting is largely formal.
- The *Executive Board* brings together the 24 Executive Directors several times a week, each Director either representing a country (China, France, Germany, Japan, Russia, Saudi Arabia, the United Kingdom, the United States) or representing a group of countries, called a constituency. In the latter case, the representative is elected every two years by all the governors of the constituency. The constituencies are generally based on geographical or historical ties. They are stable over time, even if the Articles of the IMF allow for changes.

Voting in the Executive Board is based on qualified majorities (50%, 70% or 85%), depending on the importance of the decisions to be made. Each Director's voting rights are equal to those of the country(ies) he/she represents. In practice, decisions are made by consensus, even if the underlying distribution of votes reflects the overall sense of the consensus. The Director-General of the IMF heads the Executive Board. He has a casting vote in the case of a tie (which is practically impossible, given the distribution of votes) and control over the Board's agenda. He also directs the IMF's staff (2500 persons, including 1600 economists), whose role is of prime importance, both in terms of producing information and providing analysis.

macroeconomic variables that are judged to reflect both the country's ability to contribute to the Fund and its vulnerability. The variables include: GDP, gold and foreign-currency reserves, average foreign receipts and payments (trade flows in goods and services, flows of capital income and current transfers), as well as variability of current receipts[5]. That said, the quota finally attributed is the result of a political negotiation, which may lead to a result quite different to the theoretical calculation. The actual quota of the industrialised countries taken together is far below their theoretical quota. Consequently, it is difficult to base a rebalancing of voting-rights favouring developing countries on the basis of existing formulae or even on new formulae using the same type of variables. The Cooper proposal and complementary studies carried out at the IMF show that the overall share of the developing countries cannot be raised without using a complex method of calculation and/or introducing a degree of *ad hoc* decision-making, such as an *a priori* distribution of quotas among the major country-groups. Another possibility would be to separate voting rights from quotas, by raising the fixed share of voting rights relative to the share which is dependent on quotas[6]. The issue should be decided at the twelfth five-year review of the quotas, scheduled for early 2003.

Europe's Representation

The twelfth review of the quotas could provide an opportunity for member countries to examine the appropriate representation of the European Union and the eurozone. Countries belonging to the Union presently account for 30% of the quotas (the eurozone alone standing at 23%). The 10 candidate countries which are to accede to the Union in 2004 make up a further 2%. Europe thus has a large weight in the Bretton Woods institutions. Nevertheless, its point of view does not always seem to find its way through the twists and turns of the collective decision-making process[7]. A key explanation for this discrepancy lies in the fact that Europe's votes are widely spread among countries that are not always in agreement. Furthermore, most European countries do not have a permanent Director: they belong to constituencies, in other words to country-groups represented by a sole Director. Four European countries (Belgium, Finland, Italy and the Netherlands) belong to constituencies which include countries inside and outside the EU, while two other countries (Ireland, and except in some years, Spain) are represented on the Executive Board by non-European Directors. All these countries must therefore take into account the view of non-European nations in their constituency. This makes it difficult for Europe to speak with a single voice in the Bretton Woods institutions, despite the enforced coordination for the Article IV surveillance review and efforts made to coordinate its positions in certain areas, such as the implication of the private sector in crisis resolution, or the conditionality of loans.

There are various scenarios that would allow the Europeans to coordinate their views better within the IMF. The first consists of bringing together all EU member crountries into one or several constituencies. Having a single European constituency and a single Director (though preserving the representation of each country on the Board of Governors) would have the advantage of allowing a reduction of the overall number of constituencies, from twenty-four (at present), down to nineteen (as set out in the Fund's Articles). But the prominent weight of the European constituency, which would account for 32% of the quotas once the EU enlarges, is unlikely to make this scenario acceptable to third countries. A second scenario would be to merge all European representatives into a single seat: in this case, the European Union would have a single representative both on the Board of Governors and on the Executive Board. This, however, raises a number of legal problems, as members of the IMF must be States and not groups of States (which is not the case at the WTO, where the EU is represented as such). It would, nevertheless, be more acceptable politically, in as far as the EU quota, recalculated on the basis of the Union's consolidated balance of payments (thus eliminating current account payments intra-zone) would necessarily be much

5. See. M. Aglietta & S. Moatti (2000), *Le FMI, de l'ordre monétaire aux désordres financiers*, Economica, p. 221.
6. The Cooper proposition and studies by the IMF on the formulae for calculating quotas are available at <www.imf.org>.
7. See B. Coeuré & J. Pisani-Ferry (2000), "Events, Ideas and Actions: an Intellectual and Institutionnal Retrospective on the Reform of the International Financial Architecture", *CAE Working Paper*, July, http://www.premier-ministre.gouv.fr/ressources/fichiers/DOCUMENT4.pdf.

lower. This scenario would have the advantage of providing both a single representation and a reduction in the share of European quotas, which in turn would leave greater scope for raising the representation of developing countries. The position of the EU in the IMF decision-making process would then be decided by the Council of Ministers, on the basis of the weights set out in the Nice Treaty.

In either case EU — a single constituency or a single seat — it is not clear what exactly the perimeter of EU representation would be. The formal institutional framework of the EU, as well as the strong link that exists within countries between development aid and foreign policy, would both argue in favour of a perimeter encompassing the whole of the Union. But the monetary nature of the Fund, whose resources are made up of central bank reserves, and whose interventions may interfere with the activities of the central banks, which remain lenders-of-last-resort, favours a perimeter based on the eurozone. It has also been suggested that there be a Franco-German representative, which other European countries may join progressively. This has been portrayed as a pragmatic way to move forward, within the framework of "strengthened cooperation".

It should be noted that none of these options has much international support at present. In France, the Ministry of the Economy, Finance and Industry, has shown some preference for such a long term evolution[8]. This long term objective is shared in principle by France's European partners, but raises concrete problems for countries like Belgium and the Netherlands. They currently hold majority positions in their constituencies, and would see their effective weight diminish. The Cooper Report has given a negative assessment of a possible single seat, while the IMF appears more hesitant[9].

Towards a Renegotiation of Quotas

The European quotas are recalculated here to measure the impact of introducing a single European seat. The calculations are based on four sets of possibilites (a Franco-German seat, and seats for an EU 12, 15 or 25) and use the five existing formulae. Intra-zone flows are excluded in each case (see Box 2). However, observed quotas and theoretical quotas are different, as has already been noted. Presently, they are on average 17% below their theoretical levels, for the 15 members of the EU. "Simulated quotas" are therefore calculated here for two extreme situations: either the existing spreads between the theoretical and observed quotas are retained (in relative terms), or they are eliminated. Lastly, to illustrate the implications of a single seat for the various European countries in each situation, an implicit quota has been calculated for each country, by distributing the quota of a single seat according to the weighting between the European countries set out in the Nice Treaty. The different sets of calculations are essentially conducted to provide orders of scale[10].

> **Box 2 — The CEPII Quotas Calculation**
>
> The calculation of European quotas in the various scenarios uses the five formulae that have been adopted by the IMF, excluding intra-zone current receipts and payments. In each scenario for a single seat (for 2, 12, 15 or 25 countries), the current receipts and payments of the zone provided by the IMF are corrected with respect to the share of intra-zone flows in total flows, using data from the New Cronos Eurostat database and from CHELEM. The variability of current receipts and payments is then based on the flows thus calculated. For reasons related to data availability, the extraction of intra-zone earnings for the EU25 scenario only takes into account goods trade: it is then assumed that the share of intra-zone trade is the same as that of other current transactions. Overall, the results lead to a more substantial reduction of the European quota than that provided by preliminary calculations made by the IMF in 2000 for an EU15 seat. This is mainly due to the fact that the IMF only consolidated goods trade and not services nor income on investments.

The merger of European representatives leads automatically to a significant reduction in Europe's weight in the IMF, in favour of the developing countries. But it also favours the United States, whose simulated weight rises to 20%, compared to its present 17% (see Table 1). Only a single seat for an EU15 or EU25 would allow the Union to equal the weight of the US, provided however that the theoretical quota is indeed adopted (in other words, assuming that the spread between the theoretical and observed quotas is eliminated). Similarly, a single seat for the EU12 would provide a 15% quota, and hence constitutes a blocking majority for decisions requiring an 85% majority, but only if the quotas converge on their theoretical levels.

The detailed results for the European countries show that the "big" countries of the present EU will "lose out" if their representatives are unified, especially should a large single seat emerge, in which their individual weights will be limited (Table 2). Some "small" countries in the EU (Greece, Ireland, Luxembourg and Portugal) would benefit from a single seat, as they are relatively better presented within the EU than within the IMF. The opposite applies to Austria, Belgium, Finland and the Netherlands whose

8. Treasury Directorate, "La gouvernance du Fonds monétaire international: état des lieux et pistes de réforme", in P. Jacquet, J. Pisani-Ferry, and L. Tubiana (2002), *Governance mondiale*, CAE Report No 37.
9. IMF (2002), "*The Implication of the European Union for Data on External Transactions in the Quota Formulas*", Report to the IMF Executive Board on the Quota Formula Review Group, June.
.10. The weightings used in the Franco-German case and in the eurozone case are open to question, as the Nice Treaty is not to be applied. It is nevertheless plausible that they reflect the balance of power within the Franco-German couple and the Eurogroup, as well as the likely distribution of voting rights should the Eurogroup be formalised. Furthermore, the distribution of voting rights based on the calculations put forward reflects more the apparent power among States than their real power the latter being defined as the capacity of imposing one's decisions when votes are taken. Game theory may provide a more appropriate measure. Its application to the present case is the subject of a future study.

present quotas in the IMF are relatively important. Lastly, the new members of the EU would benefit from a single, 25-country seat, while the United Kingdom, Denmark and Sweden benefit from remaining outside a single seat covering the eurozone.

Table 1 — Simulated quotas for a single European seat

As a % of total IMF quotas	Present quotas	Possible scenarios			
		Franco-German seat	Eurozone seat	EU15 seat	EU25 seat
France – Germany	11.2 – 12.2	9.8 – 10.8			
Eurozone 12	23.5 – 28.2	22.1 – 27.0	12.9 – 16.1		
EU15	30.3 – 36.6	29.2 – 35.6	20.9 – 26.0	15.6 – 19.8	
EU25	32.3 – 38.6	31.3 – 37.6	23.2 – 28.3	18.1 – 22.3	15.9 – 20.0
United States	17.5 – 16.6	17.7 - 16.9	19.6 – 19.2	20.7 – 20.7	21.3 – 21.2
Japan	6.3 – 8.3	6.3 - 8.5	7.0 – 9.7	7.4 – 10.4	7.6 – 10.7
Developing and transition countries	38.6 – 31.9	39.2 - 32.5	44.2 – 37.5	47.3 – 40.9	(46.0 – 39.6)

Note: The first figure is that of the observed quotas (first column) or of a situation in which the spread between the theoretical and observed quotas is retained. The second figure corresponds to the theoretical quotas resulting from a strict application of the Fund's formulae. For the EU25 seat, new Member States have been taken out of the "developing and transition countries" group.
Sources: Present quotas (September 2002): ww.imf.org/external/np/sec/memdir/members.htm>; theoretical and simulated quotas are based on authors' calculations (see Box 2), on the basis of the IMF's "Alternative Quota Formulae: Considerations", September 2001, Table 12, p.71-77, available at <www.imf.org/external/np/tre/quota/2001/eng/aqfc.htm>.

Overall, the most "favourable" single-seat scenario of Europe is that of the enlarged Union, but it leads to a strong dilution of the voice of the major countries within Europe as a whole. Also, the representation of the new EU members will be relatively important. This outcome is likely to be difficult to accept for those countries which are presently represented individually on the Fund's Executive Board. In contrast, a Franco-German seat would limit the

Table 2 — Implicit quotas for various European countries in the single-seat scenarios

As a % of total IMF quotas	Present quotas	Weightings in the Nice Treaty*	Possible scenarios			
			Franco-German seat	Eurozone seat EU15	EU15 seat	EU25 seat
Germany	6.1 – 7.6	29	4.9 – 5.4	2.0 – 2.4	1.9 – 2.4	1.4 – 1.8
France	5.1 – 4.7	29	4.9 – 5.4	2.0 – 2.4	1.9 – 2.4	1.4 – 1.8
Italy	3.3 – 3.7	29	3.4 – 3.7	2.0 – 2.4	1.9 – 2.4	1.4 – 1.8
Spain	1.4 – 2.0	27	1.5 – 2.0	1.8 – 2.3	1.8 – 2.3	1.3 – 1.7
Netherlands	2.4 – 3.0	13	2.5 – 3.0	0.9 – 1.1	0.9 – 1.1	0.6 – 0.8
Portugal	0.4 – 0.5	12	0.4 – 0.5	0.8 – 1.0	0.8 – 1.0	0.6 – 0.7
Greece	0.4 – 0.4	12	0.4 – 0.4	0.8 – 1.0	0.8 – 1.0	0.6 – 0.7
United Kingdom	5.1 –6.0	29	5.1 – 6.1	5.8 – 7.0	1.9 – 2.4	1.4 – 1.8
Poland	0.6 – 0.5	27	0.7 – 0.6	0.8 – 0.7	0.8 – 0.8	1.3 – 1.7
Hungary	0.5 – 0.3	12	0.5 – 0.4	0.6 – 0.4	0.6 – 0.4	0.6 – 0.7

* Based on a total of 191 for the eurozone, 237 for the EU15 and 321 for the EU25.
Sources & Note: see Table 1.

fall of quotas of these two countries, creating a joint seat whose weight could be about 10%, in other words mid-way between the United States (17%) and Japan (7%). These calculations also reflect the importance of the negotiations: a reduction in the spread between the observed quotas and their theoretical levels could reconcile the advantages of having a single European seat with a better representation of the developing countries.

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