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Lead, Follow or Get out of the way?

The European Union and Impending Bretton Woods Reform

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There have been complaints for years that power in the IMF and the World Bank is skewed to rich countries, and that developing countries have too little 'voice'. This year, there is real chance that votes in these two leading financial institutions will be redistributed in favour of large middle income countries. The momentum for this change is a growing fear that the IMF risks losing relevance: a number of Asian countries have attempted to encourage cooperation among ASEAN countries on financial and monetary issues through the so-called Chiang Mai initiative while at the same time generating vast US dollar reserves that makes IMF liquidity look paltry in comparison. Additionally, Brazil and Argentina, two of the funds largest borrowers, have made early repayments on their debt in the past year, leaving the Fund as increasingly a lender only to the poorest economies, a role arguably better suited to the Bank.

The current US proposal for a reallocation of so-called 'quota' votes, generally expected to take place at the autumn annual meeting of the Bretton Woods Institutions, entails a minor readjustment of votes in favour of Asian and other fast-growing developing countries at the expense of 'over-represented' European countries. It is a timid proposal and will fail to address the larger question of developing countries' representation. It will also disadvantage Europe, especially some of its smaller member states who are currently over-represented based on their economic power. A better solution can be found which is fair both to developing countries and to all EU members if EU countries work much more forcefully together to draft an alternative proposal.

At present, representation in the IMF and World Bank is determined primarily by a formula that attempts to capture the relative size of each country's economy. The US, for example, has more than 17% of the Board's voting power, providing it with the only veto vote in the institution (as the threshold for super-majority is 85%), and is represented as an individual state similar to the four other largest members of the board (Japan, Germany, France and the UK). Other countries are represented at the Board of Directors in constituencies, which are informally determined by country preference rather than fixed statutes. European countries are represented over a number of constituencies, most of which include non-European as well as developing countries.

To date, the limited coordination of European positions (and conflicting interests) has meant that Europe's stance on Bretton Woods reform has been reactive than strategic and proactive. This is in part the result of the current state of play in European politics. There has been progress in increasing the informal mechanisms of European coordination in the Bretton Woods during the past several years, even several joint statements in the context of the World Bank. However, Europe continues to speak largely with many voices in both institutions, despite strong priors for European cooperation and coordination in the Bretton Woods institutions – the most recent of which is the recently signed EU Development Consensus.

With European participation and leadership, current momentum for a small reshuffling of quotas could result in a more historic governance reform. Facing the likely undertaking of baby-steps towards global governance reform, Europe is seemingly left with two options: to lead or to follow. What they cannot do is block even this minimal change – they must 'get out of the way' rather than block.

Option 1: Lead?

There is an opportunity for Europe to 'call the US's bluff' by proposing – jointly – a much more far reaching reform of the Bretton Woods institutions which prioritises voice of developing countries. Several proposals have been floated by European Union members, e.g. by Germany to move the Bretton Woods institutions to a double majority system,

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where population and economic power would act as two pillars of representation, or by the governor of the Bank of England, who proposed doing away with the Board of Directors altogether. While both proposals would be consistent with pledges such as the Paris Declaration on Aid Effectiveness which call for greater country ownership of development policy, the main priority is simply to develop a European position and for it to be proactively promoted.

Representation of EU Members (in bold) in the IMF and World Bank and % of IMF quota share

Constituency	% of IMF quota share
Germany	5.99%
France	4.95%
UK	4.95%
Belgium – *Executive Director* **Austria, Czech Republic, Hungary, Luxembourg, Slovak Republic, Slovenia,** Belarus, Kazakhstan, Turkey	5.13%
Netherlands – *Executive Director* **Cyprus**, Armenia, Bosnia & Herzegovina, Bulgaria, Croatia, Georgia, Israel, Macedonia FYR, Moldova, Romania, Ukraine	4.84%
Spain – *Occasional Executive Director*[1] Costa Rica, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Venezuela	4.27%
Italy – *Executive Director* **Greece, Malta, Portugal**, Albania, San Marino, Timor-Leste	4.18%
Canada – *Executive Director* **Ireland**, Antigua and Barbuda, Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Jamaica, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines	3.71%
Nordic / Baltic Group[2] **Denmark, Estonia, Finland, Latvia, Lithuania, Sweden**, Iceland, Norway	3.51%
Switzerland – *Executive Director* **Poland**, Azerbaijan, Kyrgyz Republic, Serbia and Montenegro, Tajikistan, Turkmenistan, Uzbekistan	2.84%

Notes: **1** Mexico, Spain and Venezuela rotate leadership of the group in both institutions every two years. **2** Executive Directors rotate within the group across the two institutions between EU and non-EU members.

Option 2: Follow?

The second possible course of action is to follow the momentum for quota reallocation, while negotiating details of the agreement that will be least bad for European representation. This could include minimising European reduction to make space for Asia, perhaps by making a strong case for sharing reduction with another 'overrepresented' country or set of countries, such as Saudi Arabia or Russia. There are two shortcomings of this strategy. First, it fails to take account of larger, necessary changes in the governance of global institutions. And second, it has implications for internal EU politics. The decision to follow will be taken unequally, as the four European members of the G7 are likely to negotiate an agreement with Asian countries and the US to the exclusion of smaller non-G7 members. Such members will have to be pressured to accept a deal which will likely result in a reduction of their representation. This will further exacerbate recent tensions amongst European members.

Option 3: Get out of the Way?

Without European leadership, the quota reshuffle will likely go ahead as planned, despite significant resistance from Europe's smaller non-G7 members, who are likely to be the largest losers from such an agreement. Blocking this relatively marginal change should not be considered a serious option in either the Bank or the IMF. European resistance could probably prevent this 'change at the margins', but would endanger the legitimacy of the system: the largest developing countries could simply walk away from the institutions altogether. And both – at least potentially – serve an important role as protection against crisis in the global economic system.

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