DIIS POLICY BRIEF

The West must allow a power shift in international organizations

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Emerging market and developing countries have become increasingly frustrated with Western states for clinging to their power, in the IMF and other international organizations. Adjustments are needed and the emerging cooperation among the BRICS sends a clear signal to the West to stop stalling the process.

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OVERVIEW OF THE CURRENT STALEMATE

Everyone agrees, in principle, that the global governance organizations established after the Second World War – notably the IMF and the World Bank – must adapt their governance to the fact of a now more multipolar world. Everyone agrees, in principle, that member countries' share of votes in the governing boards should reflect their present-day relative economic weight.

At first glance the IMF has already taken a big step towards raising the voting power of "Emerging Market and Developing Countries" (EMDCs). In 2010, its member countries agreed both to boost the lending power of the IMF and to shift 6.2 % of quota shares, and hence voting power, in favour of "dynamic" EMDCs. In November 2010, Managing Director Dominique Strauss-Kahn hailed this agreement as "the most fundamental governance overhaul in the IMF's 65-year history and the biggest-ever shift of influence in favor of emerging market and developing countries".

However, more than three years later the shift has yet to be implemented, largely because the US Congress has still not approved what the US executive branch agreed to. Moreover, the key shift from developed countries to EMDCs is only 2.6%, the rest being shifts within the category of emerging market and developing countries from "overre-

POLICY RECOMMENDATIONS

- The IMF should realign quota shares to address long-standing voting power imbalances, notably the overrepresentation of European countries and underrepresentation of emerging market economies.
- The IMF should agree to a new quota formula that establishes a much closer link (than does the current formula) between relative economic weight in the world economy and voting power in the IMF.
- To preserve the voting power of the poorest developing countries, the share of basic votes in total votes should be doubled (from 5.5 % to at least 10%), so as to restore them to the same level as when the IMF was founded.
- Western states must assume responsibility for taking these steps – for the sake of boosting the effectiveness of global economic governance and checking the present drive towards "coalitions of the willing" in various plurilateral arrangements.

presented" EMDCs to "underrepresented" EMDCs. Such a small change comes nowhere close to aligning share of votes with any plausible measure of economic weight.

If economic weight is measured by gross domestic product (GDP), then the agreed 2010 reforms will still leave very large discrepancies between share of economic weight and share of voting power. On average, a dollar of EU4 (Germany, France, UK and Italy) GDP is worth more than twice as big a share of votes as a dollar of GDP from the BRIC countries (Brazil, Russia, India and China).

However, while most member states agree that, in the interests of simplicity and consistency, economic weight should be measured by GDP, the Europeans are adamant that economic weight is not just GDP but also "openness". Intra-Europe trade boosts Europe's weight, while intra-US or intra-China trade does not boost theirs. The BRICS (Brazil, Russia, India, China and South Africa) argue that if measures beyond GDP are to be included in the determination of quota and voting shares, criteria of "contributions to global growth" should be among them.

The result is stalemate on the commitment made in 2010 to revise the quota formula in time for the next reallocation of quotas. The deadline for a new formula has been postponed several times, and the latest deadline, January 2015, also seems optimistic given that the quota formula negotiations have been put on hold until the US Congress approves the 2010 reforms.

So not only has the 2010 quota share reallocation – modest as it is – yet to take effect, but the IMF is continuing forward without a legitimate quota formula, despite repeated affirmations that a new formula must be agreed. Lack of agreement suits the Europeans well, for it protects their current overrepresentation.

With this overview in mind, we will now elaborate on the discussion, even at the cost of some repetition of what has just been said.

THE 2010 QUOTA REFORMS

The voice reforms agreed in 2010 formed part of a larger post-2008-crisis compromise among representatives of the world's largest economies. The G20 summit in London in 2009 agreed to a tripling of the financial resources of the IMF, including substantial contributions from Japan, China and a number of other large emerging market economies. This took the form of New Arrangements to Borrow (NAB), which introduced a new funding channel for the IMF to supplement the standard channel of quota subscriptions paid by member states.

Unlike quota shares, these additional funds did not give contributing member countries a higher voting share in the Fund. But at the same time as they agreed the NAB, the G20 countries committed themselves to revise the governance of the Fund so as to shift quota share and voting power in favor of dynamic emerging market economies. Their communiqué from the summit in Pittsburgh in September 2009 announced that "[w]e are committed to a shift in International Monetary Fund (IMF) quota share to dynamic emerging markets and developing countries of at least 5%".

Given their marching orders by the G20, the Executive Directors set out to negotiate the shift. In 2010 they announced a major success: an agreement to shift 6.2 % in quota shares (hence voting power) from overrepresented to underrepresented countries.

But this was misleading, to put it politely. Less than half of the mentioned figure is what really matters: a shift of voting power from advanced economies to EMDCs. The G7 countries, as a group, concede only 1.8 percentage points of their voting power, in aggregate. Table 1 presents the voting power of 15 large countries, as it currently stands (as of December 2013) and as it will be if or when the 2010 voice reforms take effect.

TABLE 1
VOTING POWER, SELECTED LARGE ECONOMIES

	Current	2010 Voice reform	Change
United States	16.75	16.47	– 0.28
China	3.81	6.07	+ 2.26
Japan	6.23	6.14	– 0.10
Germany	5.81	5.31	– 0.50
India	2.34	2.63	+ 0.29
Russia	2.39	2.59	+ 0.20
France	4.29	4.02	– 0.27
United Kingdom	4.29	4.02	– 0.27
Brazil	1.72	2.22	+ 0.50
Italy	3.16	3.02	– 0.14
Korea, Rep.	1.37	1.73	+ 0.36
Turkey	0.61	0.95	+ 0.34
Indonesia	0.85	0.95	+ 0.10
Netherlands	2.08	1.76	– 0.32
Belgium	1.86	1.30	– 0.56

Note: A selection of 15 of the world's 30 largest economies, based on a 50/50 2012 GDP 'blend' (i.e. giving 50 % weight to GDP at market prices and 50% weight to GDP in purchasing power parity terms). Source: World Development Indicators (November 2013). Data for current voting power are July 2013 actual voting shares.

As can be seen, most changes are microscopic. In only two cases out of 15 large countries the change in voting power will be larger than half a percentage point (China, with a 2.26 percentage point increase, and Belgium, with a 0.56 percentage point loss).

VOTING POWER IMBALANCES REMAIN MASSIVE

Most member states agree that voting share should be closely linked to GDP share, as the simplest, least unambiguous measure of economic weight. Table 2 shows voting power-to-GDP ratios, both as of today and if and when the changes agreed in 2010 are put into effect. If voting power were aligned with GDP share we should expect all countries to cluster close to 1. As can be seen, the voting power-to-GDP ratios show a wide dispersion. They vary five-fold, from 0.45 in the case of China to 2.15 for Belgium. Not just China but also India (0.60) and Brazil (0.73) are underrepresented, while the larger European countries are overrepresented by this criterion.

On average, a dollar of GDP in the EU4 countries is worth more than twice as much as a dollar of GDP in one of the BRIC countries, in terms of voting power in the Fund. This means that the aggregate voting power of the EU4 is higher (17.6 %) than the aggregate voting power of the BRICs (10.3 %), despite the fact that the GDP of the BRICs, as a share of world GDP, is almost twice as large (24.5 %) as the GDP of the EU4 (13.4 %).

TABLE 2
VOTING POWER-TO-GDP RATIOS, SELECTED LARGE ECONOMIES

	Share of GDP 50/50)	Current	2010 Voice reform
United States	20.53	0.82	0.80
China	13.63	0.28	0.45
Japan	6.84	0.91	0.90
Germany	4.42	1.32	1.20
India	4.34	0.54	0.60
Russia	3.53	0.68	0.73
France	3.26	1.32	1.23
United Kingdom	3.12	1.37	1.29
Brazil	3.02	0.57	0.73
Italy	2.64	1.20	1.14
Korea, Rep.	1.75	0.78	0.99
Turkey	1.41	0.43	0.68
Indonesia	1.38	0.62	0.69
Netherlands	0.98	2.12	1.80
Belgium	0.61	3.06	2.14

Note: A selection of 15 of the world's 30 largest economies, based on a 50/50 2012 GDP 'blend' (i.e. giving 50 % weight to GDP at market prices and 50% weight to GDP in purchasing power parity terms). Source: World Development Indicators (November 2013). Data for current voting power are July 2013 actual voting shares.

QUOTA FORMULA REVISION IN PERIL

The problems are not just that the shifts agreed upon in 2010 have not been implemented, and that even if and when they are implemented they will leave massive voting power imbalances. On top of these is the problem of revising the quota formula that has guided allocations of shares in the IMF for decades. Successive deadlines have come and gone, with next to no agreement.

The existing quota formula allocates quota shares to member countries on the basis of four variables (with their weights in the formula given in parentheses):

- size of a member's economy, as measured by GDP (50%);
- member's integration into the world economy, or 'openness' (30 %);
- member's potential need for IMF resources, measured in terms of 'variability' of current receipts and net capital flows (15%); and
- member's financial strength and ability to contribute to the Fund's finances, as measured by its foreign exchange reserves (5%).

Instead of announcing a new formula in January 2013, as planned, the Executive Board of Directors (EBD) reported to the Board of Governors on the outcome of the Quota Formula Review (IMF 2013). The main conclusions were:
(a) "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"; and
(b) there was "considerable support for dropping variability from the formula" (IMF 2013: 2-3).

Beyond these, the Executive Directors could agree on little.

Then in October 2013, following the IMF's annual meetings, the council of ministers which steers the IMF (International Monetary and Finance Committee) declared in its communiqué:

"we urge the Executive Board to agree on a new quota formula… [and] reaffirm that any realignment in quota shares is expected to result in increased shares for dynamic economies in line with their relative positions in the world economy".

But again, in the subsequent period from October to December 2013 the Executive Board has made no progress, and recently postponed the deadline to January 2015.

UNDERSTANDING THE QUOTA FORMULA STALEMATE

At the core of the stalemate is the notion of relative country economic weight. The default position for most countries remains "share of world GDP", simply because of its simplicity. But the Europeans insist that economic weight is not just GDP but also "openness"; integration with the world economy. Not coincidentally, Europe's weight is then boosted by intra-Europe trade, while the weights of the US, China, India, Brazil et al. are not boosted by their internal trade. With this and related arguments Europeans insist that European countries are in fact underrepresented, not overrepresented – an assertion which provokes much scowling and scoffing from other participants, including the BRICS. Many countries are prepared to accept that "openness" should have some weight in the new quota formula, but say that the current measure of openness is "seriously flawed reflecting both conceptual and methodological issues" and must be replaced by a measure that avoids the positive bias for intra-Europe trade (IMF 2013: 3). And they go on to say that if "openness" is included, so should other factors. The BRICS demand a weight for "contribution to global economic growth". In response to such galloping complexity, many participants fall back on share of GDP as the only viable criterion – only to encounter outraged European objection.

MULTILATERALISM AT RISK

Many representatives from EMDCs, including the BRICS, are getting increasingly frustrated with Western determination to cling to power not just in the IMF but also in the World Bank and other important international economic governance organizations. They are plotting how to induce Western states to agree to real reductions in the Western "voice". One way is for them to move towards the exit. So they have been signaling that they – especially the BRICS – will "be more careful and selective before agreeing" to activate the New Arrangements to Borrow (NAB), in the words of a participant. And the BRICS are well along in the negotiation of a BRICS Development Bank and a BRICS Contingent [Foreign Exchange] Reserve Arrangement (for currency swaps or pooling), scheduled to be signed at the 2014 BRICS summit.

It is difficult to escape a sense that Western governments are allowing their drive to cling to power to obscure the bigger issues at stake. Western governments must go beyond their rhetorical commitment to shift voting power towards EMDCs, and actually do it – for the sake of boosting the effectiveness of multilateral economic governance and checking the present drive towards "coalitions of the willing" in plurilateral arrangements, a drive which raises the prospect of a return to the "competing power blocs" of 18th to 20th century Europe and the chronic instability they generated.

FURTHER READINGS

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