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Only basic reform can deliver legitimacy to the fund

One year ago French and Dutch voters rejected the draft European constitutional treaty. By doing so they inadvertently denied the eurogroup, the informal group of finance ministers from the euro area, the possibility of becoming a formal body. The constitution could have helped make the eurozone a more effective player on the international scene. A year later the problem has increased in urgency.

A few weeks ago, the growing current account imbalances that threaten the stability of the world economy persuaded the international monetary and financial committee, the body that oversees the International Monetary Fund, that the IMF needs "fundamental reforms" of its mission and governance. The IMF is asked to enhance "multilateral surveillance", by which Rodrigo de Rato, its managing director, means addressing the issue of global imbalances with the big member countries such as the US and China and with entities such as regional groupings that are not members, including the eurozone. The IMFC also agreed on the need for a "fair voice and representation for all members". Proposals for agreement are expected in time for the IMF annual meeting, which will be held in Singapore in September.

The link between the two issues is unmistakeable. To embark on such a challenging task, the IMF needs undisputed legitimacy. Yet Asian countries feel that their growing weight in the world economy is not adequately represented in the governance of the fund. As Mervyn King, Bank of England governor, noted in a speech a few months ago, legitimacy requires that members "feel that the ownership of the Fund is shared and that all have a voice". This means reaching a new deal on votes and seats at the IMF board.

For some time, pressure has been mounting for a reduction of Europe's share in the Bretton Woods institutions. Indeed, compare the situations: the 25-member European Union, the US, China and Japan each account for roughly 20 per cent of world gross domestic product measured in purchasing power parity and slightly less of world trade. Yet the EU occupies seven of the 24 seats on the IMF board and essentially selects the fund's managing director, who chairs the board. It also holds more than 30 per cent of the IMF quotas and votes. The US has only one seat on the board and 17 per cent of the quotas and votes, whereas China and Japan together have two seats and 9 per cent of the quotas and votes.

Europeans rightly respond that despite this situation they have far less effective power than the US. Calculations by Lorenzo Bini Smaghi, the European Central Bank executive board member, confirm that as long as EU countries fail to co-ordinate their positions, their actual power is much smaller than that of the US. On the other hand, their actual voting power would reach nearly 50 per cent (and that of the US drop significantly) if they managed to co-ordinate their votes. Even if only the members of the eurozone were to act in a unified way, their actual voting power would be twice that of the US under the current distribution of quotas and votes.

In Europe, the temptation remains to procrastinate and agree only on a minimal rebalancing of IMF quotas, postponing more fundamental reforms until later. This is a losing strategy. First, the more the Europeans wait, the lower their actual economic weight will be when reform takes place. Second, there is a distinct probability that the current global imbalances will produce big currency realignments and possibly the emergence of a strong currency arrangement among east Asian countries. If and when this happens, it is crucial that the international economy be equipped with a multilateral surveillance system where all major actors have a voice and which they can trust.

Europe should therefore take the initiative in the current discussion to reform the IMF. Countries belonging to the euro area should unify their representation within the fund as soon as possible. At the same time, they should offer to reduce quotas (and thus votes) to numbers commensurate with their economic size. In doing so, the euro area would trade off formal, but largely ineffective, power for a formally diminished but more effective influence in world economic affairs. It would also free seats and votes for Asian countries that are under-represented. This would enhance their sense of ownership of the IMF at a time when they are pondering the value of the multilateral monetary system and when the system needs them most to play their part.

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