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A single minded European representation?
From illusion and delusion to reality of a European single seat*

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Resumo/Abstract:

We justify why a single seat from European members in international fora might be preferable than a multitude of seats. Leech and Leech (2005), Eichengreen (2008) proposed this reform at the IMF. Why? Even though nowadays European Union has an aggregate voting power that is higher than its' respective (expected) share in world output or population weight; If the single seat is obtained, more coordinated expected outcomes can be achieved. This line of reasoning is compatible with the single mindedness theory created by Mulligan and Sala-I-Martin and further extended by Canegrati. Focusing in one policy gives more political power for the single European seat.

IN MEMORIAM: Ezequiel de Sousa (1945-2010)

This paper is devoted to the memory of my uncle Ezequiel, who passed away suddenly on the 26th March 2010, while a final version of this paper was being prepared. I always loved discussing the intuition of my work with him. He was an excellent listener.

Ezequiel de Sousa (1945-2010) was a gentle, noble, poly-cultured man. He was the reason why I embraced Economics. He, in the early seventies, did his BA in Business at Witwatersrand, Johannesburg and then flew to the United States to do a MBA at the University of Wisconsin, Madison. From there he developed a very successful career as a business man, from PriceWaterHouse, Partex, Gulbenkian Foundation, Sonae SGPS, and finally as business entrepreneur of his own firm.

He was a globe trotter, a true Magellan, as he loved travelling around the world. His talks would be always very instructive. He was married to Ana and a caring father of two sons Rodrigo and Daniela, from the latter, he got two wonderful grand-children Beatriz and José Maria. His legacy will always be with us and we will always cherish his witty nature.

1. Motivation

This paper, more than answer to the question of defending or not a single seat of European representation at the IMF, it aims at providing an economic rationale for theoretically justifying this unified seat. Thus, we assume that this view is more consistent and should be fore-closured the single seat.

The economic theory we use is the **single mindedness theory**, a break-through economic theory created by Casey Mulligan and Xavier Sala-I-Martin (1999; 2003). Its intuitive framework is rather simplistic as it ascertains that even if we have less votes, but a unified seat, as the decision maker is more focused on its decisions, this can, in fact, achieve more political-economic power than a multitude of uncoordinated more countries[1]. Focusing in one policy gives more political power for the single European seat.

The singled mindedness theory has been further developed by Canegrati (2006a,b; 2007a,b) to explain the role of political power by Unions in political bargaining. We can also state, intuitively, as stated in Rocha de Sousa (2009a) that for instance in landed political relations, namely in the case of land reform in Brazil, the case of the MST ("*Movimento dos Sem Terra*", Landless Workers' Movement), has also the same rationale: the fact that the MST has only one aim – to give land to those who don't have it, gives it more specifically more power as the single mindedness theory predicts.

The main motivation of this paper is thus to explain and justify economically why having a one European seat can be in fact better for Europe than the status quo. This paper joins two points of view and previous research: Mulligan and Sala-I-Martin developed the framework, Canegrati extended this framework and Rocha de Sousa had taught International Organizations where he came across with this dilemma - the one European seat proposal at the IMF.

So, on the next section we summarize the recent literature on the one European seat at the IMF.

2. Literature on the subject: From economic crisis to one European seat at the IMF

The recent European political economy literature (Alesina and Giavazzi, (2006); EC(2008); Eichengreen and Baldwin (2008); Eichengreen (2007)); describes the role of the euro as an economic stabilizer. We must nevertheless recall that the euro didn´t come

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[1] If their interests are not too much single minded.

at zero cost. For a process of transition to the euro, see Rocha de Sousa (2009b) for the transition case of Portugal, and further, Bank of Portugal (2009).

Recently Paul Krugman (2010), in his op-ed NYT article reported that the euro-area is suffering from the real first time euro asymmetrical shock. So, we might conclude that the euro area is not an optimum currency area – see Mundell (1961), McKinnon (1963). What is the solution to this problem? My view is that more integrated fiscal policies and further fiscal federalism might be the only solution to the problem. Thus, deepening and enlarging effectively the EU, and using more adequate fiscal policies might setback monetary disturbances[2]. The irrevocable commitment to the euro leads to an unthinkable impossibility of dissolution of the euro area. Some skeptics defended the exit option to distressed countries. This is clearly unthinkable in terms of pure economic rationality, because if a country has their liabilities denominated in euros, even if it adopts a new currency (ex. New escudo), the international market won´t recognize it and would demand the payment in euros, with the further problem that their (now devalued) revenues wouldn´t be enough to face the accruing current account deficit due to mounting debts. This might be compared with what happened with Argentina in 2000, when they left the peg from the currency board of 1USD to 1 peso, to devalue 40%. The reaction would be immediate and striking poverty, with social tensions arising on the streets – For a description of Argentina's crisis see Mishkin (2006).

Obviously the IMF has also a role to play in this setting of financial turmoil and currency attacks and crisis. Ostry et al. (2010) depict the role of capital controls inflows as a currency stabilizer. For an account and rationalization of the global financial 2008 crisis, see Akerlof and Shiller (2009), Braga de Macedo (2008), Mateus (2009), Rocha de Sousa (2009c), Wolf (2009). The dynamic effect of the crisis allowed Nassim Taleb (2007) to call it the Black swan effect – before having known a black swans, their probability of occurrence was zero, but as far the first black swan was seen it Australia, the probability of their occurrence jumped from zero to somewhat likely. Thus, this crisis has also been doomed as the impact of the highly improbable, rather few saw it coming, but it was also the impact of the highly improbable.

Naturally, a lot of political reforms were needed in global economic governance. If the EU wants to keep a stand on the world economic fora, they must fight for real political

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[2] It is curious that even though euro-area monetary policy created a lot of difficulties to the euro members, it is these respective countries that respectively sustain the referred monetary policy. Thanks for this comment to the WP anonymous referee.

power and dominance. The unified seat at the IMF and at other international institutions like the UN, WB, WTO might render their political and persuasion power more effective[3]. Fischer (2004) discusses the role of the IMF in the international arena, its evolution and the need for its reform.

Leech and Leech (2005) presented a paper in which they analysed the reforms of voting procedures and the effect of having a single seat for EU 12 and EU25, respectively for the Eurozone and all the EU in those years in the IMF. The principal conclusion is that even though the EU has less seats in the governors IMF council's, the structure, as admitting that there is a reduction of seats equal to the concentration on EU side, changes from a unipolar dominance from the US to a bipolar stance with two main blocks: US and EU.

Their approach is rather rigorous as they use the Banhzaff index to infer what happens in the IMF's governor's council.

The novelty is that claiming the unified seat might render more efficient policies and a greater political power for the EU. We depart from here with the aim of justifying the politico-economic rationale theory that renders more power of the EU single seat. More on this on the next section.

3. Our approach: Single mindedness theory

In this section we adapt the framework of Mulligan and Sala-I-Martin (1999) to the reality of political voting with single minded models in cabinet's of the IMF and other international institutions.

Let us consider that we have two types of countries in a (a=g, from big or large country; a=s; small country) and two types of occupations for these two countries (i=1, powerful countries and; i=2, not powerful countries).

We have two kind of decisions when voting, those favorable (f) to a given policy a other reverse (r) decision.

Besides we have a (IMF) policy vector $\Pi(.)$ which is a function of the marginal tax rates τ_{ai} (contributions to the IMF), and a function of the net transfers received (T_{ai}). The marginal contribution tax rates (τ_{ai}) are for country (a=large or small) and for countries (i=1 powerful or 2, not powerful), the same reasoning applies to the net transfer rate (T_{ai}).

Each decision maker has an indirect utility function (ϑ) with the standard economic

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[3] It rests the "minor" problem of determining the single representative.

hypothesis regarding net transfers: $\frac{\partial \vartheta}{\partial T} > 0$; $\frac{\partial^2 \vartheta}{\partial T^2} < 0$; and additionally regarding taxes: $sign\left(\frac{\partial \vartheta}{\partial \tau}\right) = sign\left(-\tau\right)$.

Besides if we have voter m of country a (=g, large or s, small) of type i (=1 or 2), voter of type m would vote for r (reverse decision), instead of f (favorable decision), if and only if:

$$\vartheta(\tau^r_{ai'}, T^r_{ai'}) + B(\Pi^r) \geq \vartheta(\tau^f_{ai'}, T^f_{ai}) + B(\Pi^f) + \delta_m \qquad (1)$$

in which δ_m is the bias for voter m to prefer candidate f choice.

There are some additional hypothesis regarding voter's m bias (δ_m). The bias is completed unobserved by the government, but political candidates know the distribution of δ_m. Its distribution is normal with mean zero and a constant variance ($N(0, \sigma^2)$). This distribution is valid for each size country cohort (a=large or small).

$B(\Pi)$ is the social concern of the voter about the behavior of other citizens (countries). This preoccupation is more with the behavior of countries than with the welfare of these countries. We have an economic decision: why do citizens in one country work and others don't? For these we specify $B(\Pi)$, in the following manner:

$$B(\Pi) = \sum_{\substack{a \in \{g,s\} \\ i \in \{1,2\}}} b_{ai} . w_a . l_a(\tau_{ai}, T_{ai}) \qquad (2)$$

b_{ai} represents the weight society gives to leisure for group country a,i; w_a is wage for given countries, $l_a(\tau_{ai}, T_{ai})$ is the fraction of age-occupation country group that is unemployed.

If society does not like "big" ("large") states to rule, independently of them being powerful or not, then we have $b_{g1} > 0$ and $b_{g2} > 0$.

The parameters $\{b_{ai}\}$ are determined by political campaign[4]. We must solve our model in a two-stage framework, using backward induction. This simply means we solve model's second stage first, and afterwards the first stage.

Second Stage

So we first begin with the second stage – **Election and determination of policies.**

The candidates countries know the cross section distribution of the voter's m biases; the voter biases are uncorrelated with size (a=g, or s) and with power (i=1, or 2).

The expected votes in candidate country r are a function of policies Π^r and Π^f in the following formula:

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[4] We disregard here credibility issues and time (in)consistency. Thanks again to the anonymous referee.

$$\sum_{\substack{a\in\{g,s\}\\i\in\{1,2\}}} \Phi\left(\frac{\vartheta(\tau_{ai}^r,T_{ai'}^r)+B(\Pi^r)-\vartheta\left(\tau_{ai'}^f,T_{ai}^f\right)-B(\Pi^f)}{\sigma}\right) \tag{3}$$

Expected *f* votes are one minus expected *r* votes. We use φ (phi) and Φ(phi caps) to denote respectively standard normal density and CDF (cumulative distribution function), respectively.

Candidates countries can choose any policy vector in the set P, which includes zero vector and each element of which satisfies the budget balance condition:

$$\sum_{\substack{a\in\{g,s\}\\i\in\{1,2\}}} T_{ai} = 0 \tag{4}$$

Candidates *r*'s f.o.c. (first order conditions) maximizing expected votes (3) subject to (4) in order to policy variables tax and transfers *(τ, T)* yield respectively:

(5) *f.o.c.* for τ:

$$b_{ai}\cdot w_a\cdot \frac{\partial l_{ai}}{\partial \tau}\cdot \sum_{\substack{a'\in\{g,s\}\\i'\in\{1,2\}}} \Phi\left(\frac{\vartheta(\tau_{a'i'}^r,T_{a'i'}^r)+B(\Pi^r)-\vartheta\left(\tau_{a'i'}^f,T_{a'i'}^f\right)-B(\Pi^f)}{\sigma}\right)$$

$$= -\phi\left(\frac{\vartheta(\tau_{ai'}^r,T_{ai'}^r)+B(\Pi^r)-\vartheta\left(\tau_{ai'}^f,T_{ai}^f\right)-B(\Pi^f)}{\sigma}\right)\cdot \frac{\partial \vartheta_{ai}}{\partial \tau}$$

(6*) f.o.c.* for T:

$$b_{ai}\cdot w_a\cdot \frac{\partial l_{ai}}{\partial T}\cdot \sum_{\substack{a'\in\{g,s\}\\i'\in\{1,2\}}} \Phi\left(\frac{\vartheta(\tau_{a'i'}^r,T_{a'i'}^r)+B(\Pi^r)-\vartheta\left(\tau_{a'i'}^f,T_{a'i'}^f\right)-B(\Pi^f)}{\sigma}\right)$$

$$= \lambda - \phi\left(\frac{\vartheta(\tau_{ai'}^r,T_{ai'}^r)+B(\Pi^r)-\vartheta\left(\tau_{ai'}^f,T_{ai}^f\right)-B(\Pi^f)}{\sigma}\right)\cdot \frac{\partial \vartheta_{ai}}{\partial T}$$

The LHS (left hand side) of the f.o.c. (first order conditions) reflects the effect of policy on social concerns, which in turn affects the votes obtained by the candidate proposing the policy.

The RHS (right hand side) of the f.o.c. (first order conditions) reflects the effect of policy on personal concern which in turn affects the votes obtained by the candidate proposing the policy.

The sign of these terms is unambiguous, because a voter selfishly wants to have a larger transfer and have undistorted labour-leisure choice.

Since these conditions are symmetrical for *r* and *f* it is expected that vote maximizing candidates would have the same policy satisfying:

$$4.b_{ai}.w_a.\frac{\partial l_{ai}}{\partial \tau} = -\frac{\partial \vartheta_{ai}}{\partial \tau} \quad \text{and} \quad 4.b_{ai}.w_a.\frac{\partial l_{ai}}{\partial T} + \frac{\partial \vartheta_{ai}}{\partial T} = \frac{\lambda}{\Phi(0)} \qquad (7)$$

We can show the following Lemma 1 (Mulligan and sala-I-Martin, 1999, adapted)

Lemma 1: The marginal tax rate for group *ai* country is positive if and only if b_{ai} is positive.

Proof: The proof follows immediately from the expression (7) above and on our assumptions $\frac{\partial l}{\partial \tau} > 0$ and $sign\left(\frac{\partial \vartheta}{\partial \tau}\right) = sign(-\tau)$.

[See Mulligan and Sala-I_Martin, 1999: 22].

In other words voters will tend to favor policies directed to retirement or unemployment incentives for a particular group of countries, if that group has managed to "convince" everyone to care for their leisure at the "campaign" stage. Notice also that if voters tend to vote in favor of work disincentives of a particular group of countries, the political successful policy will tend to make a transfer for that group, because voters tend to anticipate unemployment and are particularly sensitive to transfer policies.

The set of policies equal to zero for taxes and positive transfers *(τ, T)=(0,≠0)* is also feasible, but they will only accept them, if voters care about their own utility and not the behavior of other citizens – as Mulligan and Sala-I-Martin (1999:23) state, if and only if the b´s are zero.

Lemma 2: if indirect utility function and leisure demands functions are derived from a logarithmic utility function, then group's *ai's* post election utility is improved when b_{ai} is larger.

Proof: [Appendix 2: Mulligan and Sala-I-Martin, 1999: 33-34].

Stage 1: Political debate

The candidates and policies are debated before the election and the results of this debate are voter's preferences (namely the function B(.)). We postulate tree properties for function B(.) [Mulligan and Sala-I-Martin 1999: 23]: **i)** it is the same for every voter; as it expresses social concern for policy, it is easily accepted that this common concern can be viewed as identical for all voters; **ii)** its magnitude and shape depend upon parameters b_{ai} ;

iii) Given these parameters B is given by the time allocation of each country type.

In the "political campaign", each person (country) issues one message or advertisement, which will have the effect of manipulating the political preferences of others – specifically their preferences for other citizen's economic behavior. We, using the same framework of the authors, tend to consider that those countries more powerful (an analogy to having more employed) tend to work harder than those countries in the framework of having more unemployed, thus having more leisure tend to signal in the framework of size cohort. Thus, for instance in Mulligan e Sala-I-Martin (1999: 23): a young laywer if he expects to be employed send the following message "*all the rest need to work harder, laywers are working too hard*"; the other way round if he expects to be unemployed he would send a campaign message: "*the old need to work more, the young are working too hard*".

In our space framework, we corresponded **age** of the voters by **country size** and **occupation** by **power's country** framework. Thus, our phrases would be that a powerful state, having more employment would say: "*powerful states need to work more, less powerful states are working too much.*"[occupation = power]; the other way round if this country is facing unemployment would say: "*small sates need to work harder, large states are working too hard*" [age=country size].These messages will determine parameters b_{ai}.

SIZE	Occupation	Population	Debated parameters			
	Employment	Density	b_{g1}	b_{g2}	b_{s1}	b_{s2}
Large	Not employed	$(l_{g1} + l_{g2})/4$	b	b	-b	-b
Large	Employed1 (Powerful 1)	$(1 - l_{g1})/4$	b	-b	b	-b
Large	Employed2 (Not powerful)	$(1 - l_{g2})/4$	-b	b	-b	B
Small	Not employed	$(l_{s1} + l_{s2})/4$	-b	-b	b	B
Small	Employed1 (Powerful 1)	$(1 - l_{s1})/4$	b	-b	b	-b
Small	Employed2 (Not powerful)	$(1 - l_{s2})/4$	-b	b	-b	B
	Aggregate	1	$b\dfrac{(l_{g2} - l_{s1})}{2}$	$b\dfrac{(l_{g1} - l_{s2})}{2}$	$b\dfrac{(l_{s2} - l_{g1})}{2}$	$b\dfrac{(l_{s1} - l_{g2})}{2}$

TABLE 1: The direction of influence on debate, by size, power and employment

Source: Freely adapted from table 3 of Mulligan and Sala-I-Martin (1999: 25)

Single mindedness

Even though the result of the debate is four dimensional (**b$_{g1}$** ,**b$_{g2}$**, **b$_{s1}$**, **b$_{s2}$**) notice that from table 1, each country has only one dimensional influence on the debate. Namely the unemployed push for a policy preference for the leisure time of their size group and against the other occupation (regardless of size). This is a simple way, as Mulligan and Sala-I-Martin captured single mindedness, but in this turn for countries voting in IMF.

Table 1 presents the direction of influence in post-election utility, which is better than no influence at all, for countries. The last row of table 1 presents the aggregate of each of six groups, and the aggregation shows the importance of single-mindedness. As Mulligan and Sala-I-Martin state, use the last row of table 1, to calculate the aggregate debate parameter for the small states ($b_{s1} + b_{s2}$) and the aggregate parameter for "large" (big) states ($b_{g1} + b_{g2}$):

$$b_{s1} + b_{s2} = b.\left(\frac{l_{s1}+l_{s2}}{2} - \frac{l_{g1}+l_{g2}}{2}\right) = -(b_{g1} + b_{g2}) \qquad (8)$$

Equation (8) shows that the **size group** with more average leisure is more successful in the debate, enjoys higher utility and receives a larger transfer from government. Work tends to take attention away from size countries related issues so that when a group (say the small states (for Mulligan and sala-I_Martin the elderly) enjoys a lot of leisure, its members will tend to concentrate their effort on age related issues. That is, countries will be more single-minded if they work less. This contrasts with what happens with occupation groups (our power dimension).

Adding up the debate parameters for occupation 1 (powerful states), we get:

$$b_{g1} + b_{s1} = b.\left(\frac{l_{g2}+l_{s2}}{2} - \frac{l_{g1}+l_{s1}}{2}\right) = -(b_{g2} + b_{s2}) \qquad (9)$$

We should remark from equation (9) that the occupation group with less average leisure is the one more successful in the debate. As Mulligan and Sala-I-Martin says, in other words, the probability of success of size (or non-occupational) groups increases with the amount of leisure the group enjoys; the success of the occupation groups decreases with leisure.

Political Equilibrium Defined and Characterized

As Mulligan and Sala-I-Martin (1999) say that policy, and time allocation are determined by stage 2's election given the outcome of debate $\{b_{ai}\}$. But stage I's debate

depends on anticipated allocation of time stage 2's election. Their definition of equilibrium fits the 2 stages together more precisely.

Definition: (adapted from Mulligan and Sala-I-Martin, 1999: 27)

A political equilibrium is a pair of policy proposals (Π^r, Π^f), an allocation of time $\{l_{ai}\}$, and a set of voter preferences $\{b_{ai}\}$ so that:

i)   Labor is willingly supplied: $l_{ai} = l_a(\tau_{ai}, T_{ai})$

ii)   Expected time allocations affect the debate, and the expectations are fulfilled:

$$b_{g1} = b\frac{(l_{g2}-l_{s1})}{2}; \quad b_{g2} = b\frac{(l_{g1}-l_{s2})}{2}; \quad b_{s1} = b\frac{(l_{s2}-l_{g1})}{2}; \quad b_{s2} = b\frac{(l_{s1}-l_{g2})}{2}$$

iii)   Each candidate's budget balancing proposal maximizes his expected votes, given his opponent's proposal and given voter's preferences, for some (candidate specific) multiplier λ:

$$4. b_{ai}. w_a. \frac{\partial l_{ai}}{\partial \tau} = -\frac{\partial \vartheta_{ai}}{\partial \tau} \quad \text{and} \quad 4. b_{ai}. w_a. \frac{\partial l_{ai}}{\partial T} + \frac{\partial \vartheta_{ai}}{\partial T} = \frac{\lambda}{\Phi(0)} \tag{7}$$

iv)   The winning candidate implements his policy ($\Pi = \Pi^r or \Pi^f$)

v)   Each policy proposal balances the government budget (4).

Algebraically, as Mulligan and Sala-I-Martin (1999:27), an equilibrium is an eight policy scalars and a multiplier for each candidate, four amounts of leisure (one for each power group), and four preference parameters, solving twenty six equations[5] (four appearing in each of (i) and (ii), sixteen appearing in (iii) – two for each candidate size-occupation – and two appearing in (v).

Assuming a logarithmic utility, Mulligan and Sala-I-Martin derive the following propositions which we adapt to IMF's decisions council's:

$$u(c, l) = \ln(c) + \gamma. \ln(l)$$

Proposition 1:

If the *smaller states* have a **lower wage**, but the same **preferences** as the "great" states, then there exists a political equilibrium in which the smaller states receive a net transfer,

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[5] We assure that the solution exists due to the "isomorphism" between our problem and those of Mulligan and Sala-I-Martin. More seriously, we are disregarding problems of imperfect or incomplete information. Obviously, an extended framework for this situation might be adequate for further studies.

face a positive marginal tax rate, and are more likely to "retire".

Proof: Follow the steps in the Appendix for Mulligan and Sala-I-Martin (1999:33-34)

Proposition 2:

If the *smaller states* have a strong preference for "retirement", but the same **wage** as the "great" states, then there exists a political equilibrium in which the smaller states receive a net transfer, face a positive marginal tax rate and are more likely to "retire".

Proof: Follow the steps in the Appendix for Mulligan and Sala-I-Martin (1999:33-34).

Single minded groups

Mulligan and Sala-I-Martin argued in their framework that retirement focuses the political attention of the old on age-related policies, whereas the opposite is true for occupational groups. They showed that the occupation group with less average leisure is the most successful in the debate and enjoys higher utility and larger transfer from the government. They state "*Regardless whether occupations obtain their favors on or off-budget, our model implies that low leisure occupations are the most successful occupational lobbies (via occupational single mindedness).*" (Mulligan and Sala-I-Martin, 1999: 29).

We can transpose this setting, in which we argued that occupations stand for powerful or not powerful states, and age was replaced by countries' size (g or s)

4. Conclusion

Mulligan and Sala-I-Martin put forward the first model of single mindedness, with political single mindedness among the elderly. The model is necessarily about voting in multiple dimensions, because as they affirm, single minded only with one political issue has no meaning. Their model permitted to infer three important conclusions: i)retirement helps the elderly; ii) distortionary Social Security benefits encourage retirement and thereby elderly single mindedness, and leisure time hurts occupational single mindedness.

For our setting we conclude i) "retirement", as long run policy sustainability of the international organization helps the class of the small states (small = our old in our model); ii) distortionary fiscal benefits in favour of small states encourage "retirement", and thus single mindedness for small states; and leisure time hurts power driven single-mindedness.

Thus with these extended framework we might conclude that smaller states might

engage in single mindedness policies in the international fora. We might conclude that moving from a 27 seat big representation of the EU to a smaller sate representation, but more single minded, thus more policy focused, with one representation at the IMF, for instance might yield better results for all the EU[6].

One should remark nevertheless, that single mindedness might explain reduction of the number of seats, but a more efficient and effective single EU seat in international fora. But simultaneously, even though there is this reduction of weight in the IMF by EU, as we can see in the literature the EU seat (even reduced) still is the second largest one after the US - see Leech and Leech (2005). Thus, what we are defending is a single minded unified seat at International Organizations, but which is still very relevant, even though with a reduced weight, as it is measured by its relative weight voting power.

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[6] We are assuming again that our representatives are really representatives and do not pursue their particular interests, but only pursue, from a variety of interests, a common single minded issue.

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