



What Next for the IMF?

Edwin M. Truman

Edwin M. Truman, nonresident senior fellow associated with the Peterson Institute for International Economics since 2001, served as assistant secretary of the US Treasury for International Affairs from December 1998 to January 2001 and returned as counselor to the secretary in March–May 2009. He directed the Division of International Finance of the Board of Governors of the Federal Reserve System from 1977 to 1998. He is the author of *A Strategy for IMF Reform (2006)* and the editor of *Reforming the IMF for the 21st Century (2006)*.

Author's note: I thank without implication C. Fred Bergsten, Ralph C. Bryant, Anna Gelpern, Jo Marie Griesgraber, Miles Kahler, Clay Lowery, Scott Morris, Adam S. Posen, Steven R. Weisman, and John Williamson for their encouragement and comments on the previous draft.

© Peterson Institute for International Economics. All rights reserved.

After the Obama administration's four failed attempts in the last two years to win congressional approval of quota and governance reform for the International Monetary Fund (IMF), it is time to recognize a difficult new reality. The necessary congressional approval of an agreement reached among the world's leading economies at the G-20 summit in Korea in 2010 may be indefinitely delayed. The international community must therefore prepare for the likelihood of a new world order, in which the IMF augments its funding and reforms its governing structure without full US participation, eliminating the ability of Washington to veto certain structural policies and practices of the Fund, which the United States almost single-handedly established in 1944. The US leadership role would be not so much reduced as abandoned in a self-inflicted wound. But the alternative would be for the Fund to lose relevance and clout as the vital central institution of global economic, financial, and monetary cooperation at a time when the turbulent world economy needs its role more than ever.

The United States was the principal architect of the 2010 agreement, and there is plenty of blame to go around for the colossal and collective failure to implement it. For two years the Obama economic team did not even try to bring it to Capitol

Hill, preoccupied as they were by other matters. Then after 2012, successive attempts were made to attach IMF reform to other must-pass legislation, only to have it jettisoned in last-minute bargaining behind closed doors, most recently in the omnibus appropriations legislation of December 2014. Whoever is to blame in Washington, the rest of the world has run out of patience—understandably so. Respect for the United States in international institutions has been badly damaged, and US policy leverage has declined. The legitimacy and effectiveness of the IMF have been weakened. But this is the world that Washington has chosen by its inaction.

The international community must prepare for the likelihood of a new world order in which the IMF augments its funding and reforms its governing structure without full US participation.

Over the past year some members of the IMF started to think about the unthinkable. In October 2014, the International Monetary and Financial Committee (IMFC), the chief decision-making body of the IMF, declared: "If the 2010 reforms are not ratified by year-end, we will call on the IMF to build on its existing work and stand ready with options for next steps." IMF managing director Christine Lagarde stated on December 12, after she was informed that the omnibus bill would not contain the 2010 reforms: "As requested by our membership, we will now proceed to discuss alternative options for advancing quota and governance reform and ensuring that the Fund has adequate resources, starting with an Executive Board meeting in January 2015."¹

The world needs the IMF to function for the benefit of strong and troubled countries alike. Its participation in the stabilization programs for countries in financial crisis in Europe

1. International Monetary Fund, "Statement by IMF Managing Director Christine Lagarde on IMF Quota and Governance Reforms," Press Release No.14/568, December 12, 2014, Washington.

from Ireland to Ukraine was only the most recent example of its indispensable role. But China and other countries have grown wary of the Fund's governance because they see it as failing to recognize their increasing importance in the world economy. Congressional approval is required for the 2010 reform package, which involves an adjustment of quota shares as part of the 14th review of quotas, to go ahead. That package protects the voting share of the United States at 16.5 percent while reducing the shares of a number of advanced countries, in particular in Europe, and enhancing the shares of China and other dynamic emerging-market and developing countries.

The United States can block or veto a small number of structural decisions of the IMF, so the options available to the IMF to move forward without US cooperation are limited. This Policy Brief examines four broad options: First, the world can wait for the US Congress to pass the necessary legislation. But the new Congress if anything is more skeptical about the Fund's role in the world and more resistant to approving initiatives of the Obama administration. Second, the Fund could proceed to complete a new quota review (technically the 15th) and again wait for the United States to give its formal approval.

But two other options that allow the Fund to advance without US or congressional approval must also be considered. One way, a third option, would be to bypass the US Congress, and potentially risk the US veto, by designing an augmented reform and financing package that combines the 2010 package with the 15th review and is crafted with the implicit consent of the US administration to allow it to go into effect without congressional approval. But at a time of heightened Republican criticism of President Obama's actions bypassing Congress, this option is likely to provoke a backlash on Capitol Hill.

A fourth and final option, the most grave in terms of abandoning US leadership, would be for the Fund to propose a reform and financing package in connection with the 15th review of quotas for a "SupraFund" that would be linked to the current IMF but could be established without the explicit consent of the US government and in which the United States would have no veto. The SupraFund ultimately would effectively supersede the current IMF.

However distasteful such a step would be for Washington, a credible option for moving forward without the United States would put much-needed meaningful pressure on US politicians and policymakers. The IMF should be prepared to go it alone without Congress or even without Washington by early 2016. Option three should be preferred, because it provides for a more orderly evolution of the IMF. But if the US administration refuses to cooperate, option four should be ready to go next year.

BACKGROUND

The IMF needs to address two issues: continued reform of the IMF's governance and ensuring the adequacy of the IMF's financial resources.

The 2010 IMF quota and governance reform package, which was endorsed by world leaders at the G-20 summit in Seoul, was meant to implement the 14th general quota review for the IMF. (Such reviews normally occur every five years.) It addressed primarily the first issue: governance.² That package only marginally expands IMF financial resources potentially available from quota subscriptions and standing borrowing arrangements (the New Arrangements to Borrow [NAB] and General Arrangements to Borrow) by about \$70 billion relative to a current total of about \$890 billion.³

As of December 26, 2014, the IMF's forward commitment capacity (to finance lending over the next year) was about \$360 billion, under the Fund's conservative approach in this measure of its financial resources. Not included in this total is an additional backstop of ad hoc bilateral borrowing arrangements totaling \$418 billion as of September 4, 2014.⁴ These financial resources should be more than adequate to meet immediate requests for IMF financial assistance but not necessarily over the next decade. The bilateral borrowing arrangements are not permanent, and the remaining financial resources of the IMF are unlikely to be sufficient to support the global economy and financial system well into the 2020s; see box 1.

The expansion of IMF financial resources and reforming IMF governance are generally linked because voting shares in the IMF are based primarily on the relative size of members' quotas, which are commitments to lend to the IMF to lend to other member countries. It is normal in a quota review to increase every member's quota but to increase the quota shares of some countries while reducing them for others.⁵ The 2010

2. For more details, see Truman (2013, 2014a, and 2014b).

3. IMF quotas (a commitment by each member to lend to the IMF, which is the principal determinant of voting power in the IMF) currently are SDR 238.1 billion. Commitments to the NAB (an additional channel through which 38 members can collectively provide financial resources to the IMF) are SDR 367.5 billion. The General Arrangements to Borrow is a much smaller arrangement within the NAB involving only 11 members. The total of quotas and standing borrowing arrangements is SDR 605.6 billion. On January 5, one special drawing right (SDR) was worth \$1.47638.

4. These additional resources are available only as a second line of defense behind the NAB.

5. Ad hoc increases in one or more members' quotas are possible, as occurred in 2006, but this is not an optimal method of producing an overall shift in governance. In principle as well, a country's quota can decline in absolute size, but the country itself has to consent to such a diminution, and it has never happened in 70 years.

Box 1 The future need for additional IMF financial resources

Estimates of the future need for additional IMF financial resources are controversial. They are fraught with underlying philosophical differences about the appropriate role and scale of IMF financial support. On the one hand, some argue that the availability of large IMF resources increases moral hazard behavior on the part of borrowers and lenders. On the other hand, IMF financing is a collective public good (insurance for a financial crisis that may or may not be of a country's own making), and the larger its resources are, the less likely countries will want to run current accounts surpluses (distorting the international adjustment process) to accumulate reserves as a self-insurance mechanism.

At the technical level, we have no accepted objective way of proving *ex ante* anything about the future needs for IMF financial support. However, the following considerations are relevant.

In the past, the need for IMF financial resources has been underestimated. The 13th review of quotas was completed in January 2008 with a finding of no need to increase IMF financial resources. Following the outbreak of the virulent phase of the global financial crisis nine months later in September 2008, usable IMF financial resources from IMF quotas and permanent borrowing arrangements were more than tripled from about \$250 billion to a bit more than \$750 billion as of early 2011. That total will increase only marginally as a result of the 14th quota review that is pending implementation.

Usable quota resources will be about \$500 billion following the implementation of the 14th review, which shifts about \$250 billion from the New Arrangements to Borrow (NAB) commitments to quota commitments.

Despite reforms put in place since the global financial crisis, the scale of financial crises and the need for international support in the interests of the global economy and financial system as a whole likely will grow faster than nominal GDP.

Current ad hoc borrowing arrangements total \$461 billion, but they are not permanent. IMF permanent resources (via quotas or the NAB) should at least replace these ad hoc borrowing arrangements.

The IMF conducts a regular review of its financial resources every five years. The current 15th review of IMF quotas was expected to be completed in January 2015. The review may be extended and completed at the end of 2015 at the earliest.

Consequently, the next review would not be scheduled for completion until 2020 or five years from the completion of the 15th review.

Since it has now been more than four years since the completion of the 14th review in December 2010, and the necessary approvals have not yet been received, it is reasonable to expect that approval of any added resources from the 16th review will not be available until the mid-2020s.

It follows that deciding now on a further increase in IMF quotas (or other permanent resources) of at least \$500 billion to a total of \$1.25 trillion, if not a doubling of such resources to \$1.5 trillion, is a conservative estimate of what will be necessary to carry the IMF through the middle of the next decade.

quota and governance reform package doubled the size of total quotas, but in a technical fix, most of that increase in effect was reallocated from the NAB to quotas. The increase in the US quota commitment was offset by a reduction in its commitment to the NAB by an equal amount. Because of this arrangement, and contrary to widespread public perception, the United States is not required to commit one more dime to the IMF as part of the legislation that has failed to pass the Congress.

As part of the 2010 package, the formula used to allocate changes in IMF quotas was to be reexamined and the completion of the 15th review of quotas was to be accelerated to January 2014, with the expectation that an additional increase in IMF quota resources and a further redistribution of voting shares in the direction of faster growing emerging-market and developing countries would be proposed. The failure to meet that target has

forced the IMF to try to complete the 15th review in January 2015, which is now highly unlikely.

Thus, managing director Lagarde, the executive board of the IMF, and its members are faced with a double challenge: ensuring that the IMF has access to adequate financial resources for the next 10 years and moving the governance reform process further forward. The four options the IMF faces are discussed in the balance of this Policy Brief.

OPTION I: MORE OF THE SAME

In spite of the disappointment and anger at the US authorities for their repeated failure to deliver their formal approval of the 2010 quota and governance reform package, other members of the IMF may fail to reach agreement on what to do in response. They may continue to give the United States a free ride.

The European countries in particular, which stand to lose quota share and executive board representation as a consequence of the 2010 package and which are not eager to give up more as part of additional governance reform, may be perfectly content to let matters sit.⁶ Moreover, the European countries have put up the lion's share of the ad hoc bilateral lending arrangements with the IMF mentioned above. They may say they are willing to roll them over or to renew them in an emergency.

The emerging-market and developing countries, on the other hand, despite the best efforts of the IMF staff and management, may not be able to reach a compromise among themselves or with the advanced countries on a preferred approach. Although the current pattern is to protect the quota and voting shares of the low-income countries that are eligible to borrow on concessional terms from the Poverty Reduction and Growth Trust, within that group of countries as well as the remaining emerging-market and developing countries, faster growing countries generally gain quota share at the expense of slower growing countries, including many oil producers.

The Obama administration, for its part, is expected to include the IMF reform legislation in its budget for fiscal year 2016. It can argue that the United States stands behind its commitments, the IMF never has been starved of financial resources in a crunch, the case for a further expansion of those resources is weak given the conservative estimates of forward commitment capacity, and delays in approvals of changes in the IMF's governance and resources have been common in the past.⁷

6. The collective quota and voting shares of the members of the European Union are currently 31.9 and 30.9 percent respectively and would decline to 30.4 and 29.4 percent respectively under the 2010 package. The latest (IMF 2014) illustrative quota calculations using the current quota formula imply a decline in the EU calculated quota share to 28.4 percent and under the preferred approach of many emerging-market countries of using just the GDP blend variable (60 percent GDP at market and 40 percent GDP at purchasing power parity (PPP) exchange rates; PPP exchange rates adjust for differences in price levels among countries), the EU combined calculated quota share would drop to 22.1 percent, illustrating how disproportionate European influence is in the IMF relative to its true economic size. Note, however, that the application of any quota formula is only a starting point for negotiations on increases in quotas and that the share of any country in the resulting total of all quotas is a combination of its current share and its share based on the quota formula as adjusted in its application.

7. For example, it took two years to negotiate and approve the expansion of the NAB from the time that the United States first proposed it in 2009 and 2011 when it came into effect. The United States was in the forefront in its approval. On the other hand, it took the United States 12 years to approve the fourth amendment of the Articles of Agreement, which was also primarily a US proposal and was agreed in 1997. The amendment authorized a special allocation of SDR to roughly equalize members' SDR holdings relative to quotas with the major amount going to countries that joined the IMF after the second allocation of SDR in 1979–81, in particular to Russia and other parts of the former Soviet Union. But the Clinton administration lost interest after the 1998 Russian crisis and never submitted the amendment to the Congress. Neither did the Bush administration, ignoring frequent calls from other IMF

In summary, this option is no more than a punt and the hope that the US authorities will come to their senses. It does not offer a path for the future.

OPTION 2: RESTART THE 15TH QUOTA REVIEW

The principal drawbacks associated with the more-of-the-same option are that it would not address the longer-term financial needs of the IMF, nor would it promote the further governance reforms anticipated at the time that the 2010 package was completed as part of the 14th quota review. Consequently, another option is to restart the process anticipated in 2010 to review, and presumptively to revise, the IMF quota formula and to use the new formula as a basis for a second package of IMF governance reforms linked to an increase in total quotas and a further redistribution of quota shares as part of the 15th quota review. It is unlikely that this process will be completed by the end of January 2015 as was anticipated a year ago, but it would be feasible to complete the 15th review by the end of 2015.⁸

For the reasons described in box 1, a plausible target for an increase in IMF quotas is a further doubling relative to what the 14th review is expected to produce. This would imply an increase in IMF financial resources of about 75 percent.⁹

Under this option, the IMF governors would approve by an 85 percent majority vote a resolution concluding the 15th quota review. The resolution would list the proposed additions to members' quotas on top of those associated with the as yet not implemented 14th review (2010 package) and set the level of consents for the proposed increases to go into effect—in other words, for the 15th review to be implemented. Table 1 illustrates the implications for IMF quota shares of such an approach (see box 2 for additional discussion).

If it were to follow prior practice, the United States would insist that the level of consent be at 85 percent so that the proposal could not be implemented until the United States, via congressional action, had given its consent.¹⁰ This would

members to approve the amendment. It was submitted to the Congress by the Obama administration as part of the implementation of the agreements at the G-20 London Summit and was approved by the Congress in July 2009.

8. IMF quota reviews, when they propose changes in quotas, are completed by the passage of a resolution by the governors of the IMF by an 85 percent majority.

9. The remainder of regular IMF resources comes from the potential to draw on the NAB; see footnote 3. The post-2010 package NAB could also be doubled to accomplish a doubling of total IMF resources, but that possibility is not central to the analysis in this Policy Brief.

10. If the US authorities were to embrace this option, they would be well advised to consult more openly and consistently with the US Congress about their intentions than has been the case in the past. This is the normal procedure with respect to US capital contributions and replenishments of funds in multilateral development banks.

Table 1 Implications for quota shares from proposed and prospective quota reforms (percent)

Country or country group	Quotas			Blend GDP ^b
	Current	2010 package	2015 calculated ^a	
Advanced	60.5	57.6	52.6	53.0
United States	17.7	17.4	14.9	20.5
European Union ^c	31.9	30.4	28.4	22.1
Japan	6.6	6.5	6.0	7.0
Emerging market and developing	39.5	42.4	47.4	47.0
BRICS ^d	11.4	14.8	19.3	23.6
Brazil	1.7	2.3	2.4	3.2
Russia	2.5	2.7	3.0	3.0
India	2.4	2.7	2.8	4.2
China	4.0	6.4	10.5	12.6
South Africa	0.8	0.6	0.6	0.6
Low-income ^e	3.2	4.1	3.0	2.5

a. Share based on current quota formula and 2012 data.

b. 60 percent of GDP at market and 40 percent of GDP at purchasing power parity exchange rates.

c. About 15 percent of the EU shares are for countries classified as emerging market and developing.

d. Countries may not sum to total because of rounding.

e. Eligible for borrowing from the Poverty Reduction and Growth Trust with annual per capita income below the prevailing International Development Association (IDA) cut-off in 2008 or below twice IDA's cut-off for countries meeting the definition of "small countries" for the current column as of December 2010 and 2013 updated eligibility for the remaining columns.

Sources: IMF (2010) and IMF (2014).

preserve the ability of the United States to block or veto certain actions by the Fund that require an 85 percent majority.¹¹

The difficulties in reaching agreement on this option are formidable; see box 2. The emerging-market and developing countries want a substantial revision of the IMF quota formula tilted toward increasing their collective share of quotas and votes, but there is no agreement among that group on how to do this because any approach involves losers as well as winners within that group of countries.

11. The principal actions subject to the 85 percent majority are: approval of an adjustment in quotas, amendment of the IMF Articles of Agreement, and allocation of SDR. However, there are 20 other actions by one or more bodies of the Fund that require 85 percent majorities for approval. The resolution approving the 14th review required only that a 70 percent majority of the members consent to the increases in their quotas; as of September 5, 2014, 79.64 percent of the votes had approved. The 2010 package has not gone into effect because the effectiveness of the entire package was tied to approval of an amendment to the Articles of Agreement to require that all executive directors be elected. (Currently the five members with the largest quotas appoint their executive directors.) The objective of this amendment is to facilitate the reduction in the number and consolidation of European seats on the executive board. That amendment cannot go into effect until 60 percent of members with at least 85 percent of the votes have approved; as of September 5, 2014, 77.66 percent of the members with 77.07 percent of the votes had approved the amendment. Thus, the 2010 package as a whole requires US approval with its voting share of 16.7 percent.

The European countries are not enthusiastic about committing to a further decline in their collective quota and voting share.

The United States, for its part, can be expected to resist a substantial and mechanical application of the current quota formula because it would imply that the US voting share, in the views of some, would be edged dangerously close to the point where the US voting share would be insufficient to block major decisions of the IMF, i.e., less than 15 percent.¹²

Moreover, many members would be reluctant to adopt another IMF governors' resolution on this subject until the 2010 reform package has been approved.¹³

12. See footnote 11.

13. One can imagine an intermediate option between the first and the second: The IMF governors could pass a resolution approving ad hoc increases in the quotas of a selected group of countries, such as those that are to receive disproportionate increases as a result of the 14th quota review but where the increase in aggregate quotas was not large enough to push the US quota voting share below 15 percent and would not be additional increases in quotas expected from the 2010 package. A back-of-the-envelope calculation suggests that there is about a 1.5 percentage point of current total quota shares to play with on this basis. If it all went to emerging-market and developing countries, their combined quota share would increase by this amount, compared with the 2.9 percentage point increase under the 2010 package. Thus, this intermediate op-

Box 2 Illustration of a prospective quota reform

The object of this Policy Brief is not to go deeply into the possible revision of the IMF quota formula and its implications. However, the review of that formula is likely to result in calculated quotas somewhere between the data presented in the last two columns of table 1.¹

The third column in the table shows calculated quotas based on data through 2012 on GDP, openness, variability of current receipts minus net capital flows, official reserves, and the 2011 global estimates of purchasing power parity (PPP) exchange rates produced by the International Comparison Project (IMF 2014). The last column shows the distribution of blend GDP (60 percent at market and 40 percent at PPP exchange rates) without the use of a compression factor that penalizes large economies.²

The results of a revision in the quota formula are likely to produce shares of calculated quotas between those shown in these two columns. The formula results will be used only as a starting point in the negotiation of a new quota agreement.

As can be seen from table 1, an emphasis on GDP in the current blend proportions produces little difference in aggregate quota shares for advanced and emerging-market and developing countries, but it would tend to favor, or not to disfavor, the individual large economies shown in the table. The European Union as a group would not be favored, however.³ In addition, the low-income countries would not be favored by the strict application of the current quota formula or by an emphasis on blend GDP, but under current practice, the quota and voting shares of these countries as a group will be protected, which implies that combined quota shares of the advanced and other emerging developing countries would be slightly smaller than those shown in the table.

In addition, the underlying data in table 1 are due to be updated to 2013 by the middle of 2015. The new data can be expected to emphasize the trends revealed in the data through 2012: larger shares for the emerging-market and developing countries and smaller shares for the advanced countries, in particular the slow-growing members of the European Union.

In general, the application of the quota formula involves two components: an equiproportionate increase in each country's current IMF quota and an increase distributed according to the quota formula using the most recent data.⁴ More weight placed on the first component increases the historical inertia in actual quotas. More weight placed on the second component increases the pace of change in quotas and IMF governance. If the 15th review doubled the quotas as of the 14th review (the 2010 package) and all the weight were placed on the second component, the new quota shares would be the average of the two columns. The combined share of the advanced countries would decline by 2.5 percentage points and that of the emerging-market and developing countries would rise by the same amount, which is slightly less than the change associated with the 2010 package itself. The US share would fall to 16.2 percent and the EU share to 29.0 percent.⁵ Except for China, the quota shares of the other members of the BRICS group would increase only marginally; China's quota share would increase to 8.42 percent to more than Japan's share at 6.25 percent.⁶

1. Calculated quotas are those produced by application of the quota formula.

2. The current (2008) quota formula includes four variables (GDP, openness, variability, and reserves), expressed in shares of global totals, with the variables assigned weights totaling to 1.0. The formula also includes a compression factor that reduces dispersion in calculated quota shares.

The formula is:

$$CQS = (0.5*Y + 0.3*O + 0.15*V + 0.05*R)^k$$

Where CQS = calculated quota share;

Y = a blend of GDP converted at market and PPP exchange rates averaged over a 3-year period. The weights of market-based and PPP GDP are 0.60 and 0.40, respectively;

O = the annual average of the sum of current payments and current receipts (goods, services, income, and transfers) for a 5-year period;

V = variability of current receipts minus net capital flows (measured as a standard deviation from the centered 3-year trend over a 13-year period);

R = 12-month average over a year of official reserves (foreign exchange, SDR holdings, reserve position in the Fund, and monetary gold); and

k = a superscript compression factor of 0.95. The compression factor is applied to the uncompressed calculated quota shares, which are then rescaled to sum to 100.

3. Because of the arcane presentation of IMF quota calculations, the EU grouping shown in the table includes not only advanced but also emerging-market and developing countries. Only 11 of the 28 EU members are classified in these presentations as advanced countries, but those countries account for a disproportionate share of the EU line in the table: 27.4, 25.4, 23.1, and 18.9 percentage points for the four columns in the table, between 80 and 85 percent of the data for the European Union as a whole.

4. Various ad hoc factors may also be employed, such as an emphasis on the extent to which actual quotas are out of line with the calculated quotas based on the formula or an emphasis on faster growing economies; these adjustments tend to increase or magnify the weight on the second component.

5. The US voting share would fall to 15.3 percent; the US voting share is less than the US quota share because it is equal to 1/188 of the 5.502 percent in basic votes set aside for each member plus 94.498 of its quota share.

6. The quota shares of the United States, Japan, and the BRICS would be higher if the quota formula gave more weight to blend GDP.

Nevertheless, adoption of a governors' resolution on the 15th review might well be viewed as being in the interests of the IMF as a whole and consequently in the interests of its individual members. It would signal intent to act to reform IMF governance further, even if its implementation would be delayed to an uncertain future date. It would also put in place the capacity to increase the IMF's quota resources if the need should arrive rather than having to rely on ad hoc borrowing or to mobilize from scratch an increase in IMF quotas. The US executive branch or the legislative branch might allow the two proposals to languish until it became clear that the IMF critically needed additional resources. The US authorities could argue that they have acted to push forward slightly the ultimate prospect of further IMF quota and governance reform. But fundamental questions about the future of the IMF and US support for the IMF would remain.

OPTION 3: RISK LOSING THE US VETO

A more promising approach would involve US administration support for an augmented reform and financial package that could go into effect without the approval of the US Congress.

The key procedural feature of this option is that it can be implemented without action by the Congress. US law requires congressional approval to implement an increase in the US IMF quota, but congressional approval is not required for the United States to vote favorably on an IMF governors' resolution to increase its own quota, subject to congressional approval, or the quota of any other IMF member. Moreover, a governors' resolution involving an increase in the US quota can be drafted to delink formal US approval of the increase in its own quota from implementation of the overall resolution. The US treasury secretary can vote in favor of an overall quota reform package, which could be implemented even if the US Congress fails to approve US participation. Implementation might, for example, require acceptance of increases in IMF quotas by countries with only 70 percent of total votes.

This option has four basic elements.¹⁴

First, set aside the 2010 IMF reform package with its three interlinked components that in effect require congres-

sion would deliver in the interim half the 2010 result, with the remainder still pending approval by the US Congress of the 2010 package. This intermediate option would underscore the precariousness and game playing with respect to the US veto. Moreover, it would not satisfy the expectation that there should now be a further installment of governance reform in connection with the 15th quota review.

14. See Edwin M. Truman, "Time for the United States to Risk Its IMF Veto," Real Time Economic Issues Watch, April 11, 2014, Washington: Peterson Institute for International Economics.

sional approval of the US quota increase for any of them to be implemented.¹⁵

Second, resubmit to the IMF membership the amendment of the IMF Articles on an all-elected IMF executive board as a stand-alone proposal, which would continue to require an 85 percent majority vote for its approval.

Third, combine the IMF quota reform component of the 2010 package with the 15th general review of quotas, as discussed under the restart option.

Fourth, based on the assumption the United States would risk losing its veto power at least temporarily if the new combined quota and governance reform package were to be implemented:

1. Revise the quota formula to increase the weight of the GDP blend variable—60 percent GDP at market and 40 percent GDP at purchasing power parity (PPP) exchange rates—from its current 50 percent to 90 percent.¹⁶
2. Double total IMF quotas again relative to their size anticipated in the 2010 package; see box 1.
3. Provide in the IMF governors' resolution that changes in quotas will take effect when formal consents are received from members with less than 83.3 percent of the total voting power in the IMF, say 75 or 80 percent.¹⁷

One should not underestimate the challenges associated with reaching agreement on this option.

Reconfiguring the 2010 package might be considered risky by some members; after all, it has almost been approved and some members would want to be sure to preserve their gains, or contain their losses, in quota shares resulting from that review. Importantly, the revision of the IMF quota formula would be resisted by the EU members of the IMF and many of the smaller or slower growing emerging-market and developing countries. Most difficult of all would be obtaining the agreement of the US administration to risk the US veto in the IMF.

15. See Truman (2013, 2014a, and 2014b).

16. A weight of 10 percent could be shared by the three variables in the current formula (trade openness, variability of net current receipts, and official reserves), or one or more of them could be dropped. My preference would be to drop the openness variable, which now receives a weight of 30 percent and largely benefits the smaller European economies, and reduce the weight on the variability variable from 15 to 5 percent and retain the weight on the official reserves variable at 5 percent. The latter variable, though, has outlived its relevance and is counterintuitive in the current environment because it rewards the antisocial behavior of countries running current account surpluses in order to build their reserve balances.

17. Recall that the US voting share is 16.7 percent.

The three elements of the reform package should be seen as an integrated whole if it is to appeal at all to US authorities in the executive or legislative branches.

With respect to the first element, the quota formula, the US calculated quota share might actually rise rather than fall. Importantly, the combined quota share of the European Union would likely fall more than implied by the restart option. This aspect should be attractive to the emerging-market and developing countries, particularly if the United States were to cede a portion of the implied increase in its quota to those countries.

With respect to the second element, the further doubling of IMF quotas, the case for doing so to carry the IMF through to the middle of the next decade is discussed in box 1.

The third element is the most radical, but its inclusion in this option is dependent on the first two to make the approach minimally palatable to the United States. The United States would be potentially deprived of the capacity to block the implementation of the new quota and governance reform package via its nonapproval of an increase in the US quota. The United States would be forced to put up or shut up if it wanted to maintain its dominant role in the IMF. Absent action by the US Congress, when other IMF members with a sufficient share of total votes approve the increases in their quotas, the US quota and voting share will be reduced to about one quarter of its current size.¹⁸ The United States would lose the capacity to block singlehandedly other institutional changes in the IMF. That loss likely would be temporary because normally countries that have not yet consented to increases in their quotas are granted a grace period to do so after the initial proposal has taken effect; they have a second chance. I presume that this would continue to be the practice because the United States would not be the only country that had not yet consented to the increase in its quota and ultimately the US Congress would act positively.

No doubt, many in the US Congress would be outraged by another action by the executive branch that avoids congressional action, even though the option, as detailed above, rests on strong legal foundations. Outraged members of Congress might well exact retribution from the administration for its action in multiple areas. More thoughtful members of Congress, on the other hand, might recognize, in particular when reminded by the administration, that this situation would not be without precedent. The United States regularly runs the risk of losing its

18. Under the 2010 proposal, the US quota would be approximately doubled along with total quotas. Under this option, total quotas would be doubled again. Absent US consent, its quota would be unchanged and its share would be about a quarter of its current share. Adjusted for the fact that total quotas would be reduced by the absence of increases in quotas of the United States and a few other members, the reduction might be only to 5 percent rather than to 4.4 percent.

blocking voting share in connection with capital increases and replenishments of many of the multilateral development banks, and the Congress generally responds positively if sometimes with a lag.

This approach to IMF quota reform does offer something to IMF supporters in the United States. It further advances IMF reform and could preserve the existing US voting share in the IMF while also putting the United States on the spot to participate. If the US authorities were to accept this option, the United States would recover some of its leadership role by acting responsibly to forestall the potential ossification of the IMF. On the other hand, the United States might balk, and the IMF would have to look for other ways to get around US intransigence to advance IMF quota and governance reform.

OPTION 4: BYPASS THE UNITED STATES

Faced with the United States unwilling to risk losing its veto in the IMF by embracing the third option, and unwilling to allow a dysfunctional US political system to continue holding the IMF hostage but wanting to preserve the institution's central position in the international monetary and financial system, the other members of the IMF could put in place an augmented reform and financing package without the consent, or potentially the participation, of the United States. The objectives of this option would be to eliminate permanently the US veto in the Fund, promote governance reform, and provide the combined institutions with added financial resources for the future.

This option would establish a "SupraFund" separate from but linked to the current IMF with almost all of its features. The SupraFund would be empowered to lend to the current IMF. The members of the SupraFund would commit themselves to all the obligations and procedures associated with the current IMF with one exception. The exception would be that the 85 percent majority required for some decisions in the IMF would be reduced at least to 80 percent, and the decisions requiring 70 percent majorities might be reduced commensurately.¹⁹ Reducing 85 percent majorities merely to 80 percent would imply that EU members as a group with a current voting share of 30.9 percent and a voting share of 29.4 percent under the 2010 package would retain their effective veto. This result would be unattractive to many other members. It would argue for a reduction of the 85 percent majorities to 70 percent majorities.

For its part, the current IMF would establish a borrowing arrangement with the SupraFund. Such a decision, as with the NAB, General Arrangements to Borrow, and ad hoc bilateral

19. Recall from footnote 11 that 23 decisions by the IMF now require 85 percent votes; in addition, 22 decisions require 70 percent votes.

borrowing by the IMF, requires only a simple majority of votes of the members under IMF Article VII, section 1.²⁰ In other words, the United States alone could not block this decision.

The current membership of the IMF could establish a SupraFund with the same membership as the IMF. The management, executive board, and staff of the SupraFund in the first instance would be identical with the current Fund. The resources of the SupraFund would be the addition to the IMF quotas from the 15th quota review—possibly a doubling of the

The other members of the IMF could put in place an augmented reform and financing package without the consent, or potentially the participation, of the United States.

quota resources of the IMF anticipated after the 2010 agreement (the 14th review) had become effective. The members of the SupraFund would have to agree on a quota formula or key for the distribution of quotas in the SupraFund, which as discussed above would not be easy. However, the emerging-market and developing countries could expect to have close to the majority of the voting power in the SupraFund—columns 3 and 4 of table 1—even if all members of the IMF including the United States participated.²¹

The temptation to make changes to the IMF Articles of Agreement, in addition to the voting majorities, when they are incorporated into the articles of the SupraFund would be strong. Added changes should be resisted. Otherwise, the negotiations would be prolonged, and the risk of a large number of

members of the current IMF not participating in the SupraFund would rise, which would weaken its authority and legitimacy. This challenge illustrates just how difficult it would be today to reconstruct from scratch the institution that was founded 70 years ago. Since IMF members are free to withdraw, it also illustrates the continuing value of that construction, no matter how imperfect it is perceived to be, in binding countries together in a common purpose.

Over time, the size of the SupraFund would expand relative to the current IMF since there would be no need to grow the old IMF. This process could be accelerated by terminating the NAB when it comes up for renewal in March 2016 and transferring some or all of the potential resources in that arrangement to the SupraFund either in the form of additions to quota resources or a new NAB for the SupraFund.²²

It would be desirable that the SupraFund not require a supermajority to approve lending to the IMF, as is now formally the case with NAB lending to the IMF. If membership in the SupraFund was nearly universal, and the organization and decision making of the two institutions were essentially the same, it would not matter how the lending was done.

If the IMF membership decides it is necessary to put forward this option, I would hope that the United States would join the SupraFund and accept the hastening of the inevitable day when its capacity to block certain decisions in the IMF has been eliminated because its size relative to the global economy has shrunk. This would be a complex way of implementing that reality, but it is one that should be actively considered given that the United States recently has been irresponsible in exercising its capacity to block a needed, important evolution of the IMF in the form of the 2010 reform package.

The impasse over implementation of the 2010 reform package has seriously damaged US leadership and leverage in the IMF with spillovers into other areas of international economic and financial cooperation such as standards governing financial institutions and trade agreements. Partners will increasingly ask: Is it worth doing business with the US executive branch if the US legislative branch will resist or reject resulting international agreements?

The impasse also threatens the central role of the IMF itself because its financing and governance essentially have been frozen. This has in turn accelerated the tendency to replace the IMF (and its Bretton Woods twin, the World Bank Group) with other institutions of international economic and financial cooperation in which the United States has little or no influence—such as the New Development Bank (established by Brazil, Russia, India,

20. The language is:

The Fund may, if it deems such action appropriate to replenish its holdings of any member's currency in the General Resources Account needed in connection with its transactions, take either or both of the following steps:

- (i) Propose to the member that, on terms and conditions agreed between the Fund and the member, the latter lend its currency to the Fund or that, with the concurrence of the member, the Fund borrow such currency from some other source either within or outside the territories of the member, but no member shall be under any obligation to make such loans to the Fund or to concur in the borrowing of its currency by the Fund from any other source;
- (ii) require the member, if it is a participant, to sell its currency to the Fund for special drawing rights held in the General Resources Account, . . .

21. If the United States were unwilling to participate because of the executive branch's resistance or unable to do so because of the legislative branch's nonapproval, the quotas and voting shares of the emerging-market and developing countries would be that much larger: The data on blend GDP in column 4 of table 1 imply that the quota share would be about 59 percent (47 divided by the total less the US share of blend GDP, or 0.795). The voting share would be a couple of percentage points higher.

22. The process of creating a SupraFund on top of the original IMF would be analogous to the establishment and subsequent enlargement of the NAB on top of the original General Arrangements to Borrow.

China, and South Africa with an emergency lending component), the Asian Infrastructure Investment Bank (led by China), the Chiang Mai Initiative Multilateralization (an Asian self-help financing arrangement), and the European Stability Mechanism (a European self-help financing arrangement). These trends promote the further fragmentation of the international monetary cooperation that underlies everything that the IMF does to promote global economic growth and financial stability.

This Policy Brief has outlined four options to break this

impasse. The first two options (doing nothing and waiting for the US Congress to act and restarting the 15th quota review) do not promise to break the impasse, much less move the process of IMF governance reform forward. Consequently, IMF members and the US executive branch should consider the third option (risking loss of the US veto) to bring pressure on the US Congress. If the US executive branch declines to cooperate, the fourth option (bypassing the United States to create a new SupraFund) should be developed as a credible threat.

REFERENCES

IMF (International Monetary Fund). 2010. *IMF Quota and Governance Reform: Elements of an Agreement, Updated Tables*. Washington: International Monetary Fund.

IMF (International Monetary Fund). 2014. *Quota Formula: Data Update and Further Considerations*. IMF Policy Paper (August). Washington: International Monetary Fund.

Truman, Edwin M. 2013. *The Congress Should Support IMF Governance Reform to Help Stabilize the World Economy*. Policy Brief in International Economics 13-7 (March). Washington: Peterson Institute for International Economics.

Truman, Edwin M. 2014a. *IMF Governance Reform Unfinished Business for the 113th Congress*. Real Time Economic Issues Watch (November 12). Washington: Peterson Institute for International Economics.

Truman, Edwin M. 2014b. *IMF Reform Is Waiting on the United States*. Policy Brief in International Economics 14-9 (March). Washington: Peterson Institute for International Economics.

This publication has been subjected to a prepublication peer review intended to ensure analytical quality. The views expressed are those of the author. This publication is part of the overall program of the Peterson Institute for International Economics, as endorsed by its Board of Directors, but it does not necessarily reflect the views of individual members of the Board or of the Institute's staff or management. The Institute is a private, nonprofit institution for rigorous, intellectually open, and indepth study and discussion of international economic policy. Its purpose is to identify and analyze important issues to make globalization beneficial and sustainable for the people of the United States and the world, and then to develop and communicate practical new approaches for dealing with them. The Institute is widely viewed as nonpartisan. Its work is funded by a highly diverse group of philanthropic foundations, private corporations, and interested individuals, as well as income on its capital fund. About 35 percent of the Institute's resources in its latest fiscal year were provided by contributors from outside the United States. A list of all financial supporters for the preceding four years is posted at <http://piie.com/supporters.cfm>.