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Divided US Congress hampers IMF Reform

Written by Christopher Wood

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From 11 to 13 April, thousands will gather in Washington, DC for the annual Spring Meeting of the International Monetary Fund (IMF) and the World Bank Group. The key issue on the table will be IMF reform. Waning US leadership of the process is threatening the stability of the global economy, says Christopher Wood ahead of the meeting.

No single country could have stopped the 2008 global financial crisis. With enormous, interconnected global financial flows that move at breathtaking speed, crises have the potential to quickly snowball beyond control. There is the need for a robust international organisation that can act decisively to counteract shocks before they become full-blown crises, and the International Monetary Fund (IMF) has every potential to fulfill this role. But for the IMF to act decisively and legitimately, reform is needed.

A first step in this reform is ready and waiting to be implemented, but has been stuck for four years before an American Congress that refuses to ratify it. This failure threatens the stability of the global economy and, above all, threatens America's place in a fast-changing world.

Emerging economies have been calling for reform of the IMF for decades. The Fund has come in for withering criticism, often caricatured as the harbinger of neoliberalism and as a puppet of Western powers. Emerging countries still bear the memories of difficult structural adjustment programmes attached as conditions to IMF assistance, while developed countries bemoan IMF intervention in economies with records of reckless spending. The Fund has tried to address its perception challenges on an operational level but, regardless of their merits, IMF actions will always be hard to swallow when coming from an undemocratic and unrepresentative institution.

The IMF is governed by two mechanisms. The Board of Governors is the highest decision making body. All 188-member countries are represented on the Board, but voting power is weighted according to the amount of money each country contributes, through a quota system. This monetary basis provides for an asymmetric voting structure, which is broadly accepted as necessary to maintain the participation of the richest countries. More problematic is that the quota no longer reflects economic reality, with the likes of China having less influence than France, and Brazil holding less voting power than Belgium. A similar imbalance is reflected in the Board of Executive Directors, which is appointed by the Governors and makes most operational decisions. Of the 24 members, five are directly appointed by the US, Japan, Germany, France and United Kingdom. The remaining 19 are elected, either by blocs of countries or by the three countries with a large enough voting share to directly choose their representative - namely China, Russia, and Saudi Arabia.

A comprehensive deal on IMF reform was agreed in 2008, offering three major changes.

First, the size of the IMF's quota was doubled, to around USD$725 billion. This moves the quota from the current low baseline of less than 0.3% of global capital flows. While this is an unprecedented increase in quota commitments, much of this funding comes from a roll-back of temporary financing arrangements, such as the USD$570 billion 'New Arrangements for Borrowing' (NAB) fund.

Second, changes in the quota share increases commitments from the developing world, meaning these countries gain more influence. The reforms give China the third largest quota share and move Brazil and India into the top ten, while overall increasing emerging country quota share by 6%. South Africa doesn't fare quite as well, facing a small reduction in quote share, but nevertheless supports the reform as a means to promote emerging country interests.

Finally, all 24 members of the IMF Executive Board would now be elected, removing the five slots reserved for direct appointment.

The reforms were championed by the US, and widely accepted by the membership. As of the beginning of 2013, 130 countries representing 70.24% of voting power had approved Board Reform, while 134 members representing 77.07% of voting power had approved quota reform. But final approval can only come with 85% of the voting share, and since the US' vote counts for over 15%, their signature is needed to pass the bill.

Getting that signature requires approval from a bitterly divided United States congress, and therein lies the problem. Getting anything through congress is difficult, but it is particularly so for a bill with no domestic constituency, which is hard to explain at the best of times and impossible to justify at the worst. Backing a bill that gives additional power to America's would-be rival China is particularly challenging, as is anything that requires new appropriations.

But IMF reform does not damage the US. Its voting power decreases very marginally, from 17.69% to 17.40%, but remains high enough to maintain an effective veto over any major decisions. Reforms are very unlikely to increase the financial burden on the US. While the US's quota commitments do increase, this is offset by decreasing contributions to additional funds like the NAB. In the worst case scenario, the US might have to put up an additional USD$315 million, roughly the cost of two of the US's 2,337 newly-ordered fighter jets.

While the current reforms will probably be passed eventually, there are tangible costs to delays. The greatest cost is to America's continued status as a leader in global cooperation efforts. For all the resistance to US dominance in global arenas, it nevertheless has a reputation for decisiveness, willing to take the actions needed to reach an agreement it believes in. A partisan congress, unwilling to set aside differences for the global good, undermines this image and deepens skepticism of the reliability of the US as a global actor, which is already at a low ebb after the farcical politicking around the extension of the debt ceiling. An America that is self-centered and schizophrenic can achieve nothing, and will be left behind at the very moment in which its influence is most open to being supplanted by rising superpowers like China.

The impact is already being felt. As the BRICS grouping meet in July, there is likely to be a deepening of regional and plurilateral efforts to ensure financial stability, in this case the further development of the Contingent Reserve Arrangement, an 'IMF-lite' for BRICS, and the deepening of currency swap arrangements. While these mechanisms are a useful safeguard against instability, they reduce the incentives for countries like China and India to make the IMF as strong as possible. An IMF with waning support costs the US budget just as much, but undermines the institutional power of the Fund, meaning less bang for each American buck.

IMF reform should be remembered as a triumph of American leadership and willingness to cooperate with the developing world, a shot against critics who bemoan a new era of American isolationism. Further unnecessary delays will do nothing but undermine this victory.

Congress has the rare opportunity to pass a bill that Republicans, Democrats, the broader United States, and the rest of the world agree on. They must not let that opportunity pass by.

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