US blockage at the IMF puts financial stability at risk

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The governing committee of the International Monetary Fund said in its communique after last week's Spring Meetings that it was "deeply disappointed" at the lack of progress in doubling the Fund's secure lending resources.

At stake is the Fund's ability to provide emergency loans to countries in financial or balance of payments trouble. With the global economy mired in a "stop and go" recovery "at risk of stalling again", according to the latest Brookings Institution-Financial Times tracking index, the demand for such loans is likely to rise and global financial stability is at risk if the Fund cannot provide them.

Currently the Fund's ability to lend depends too much on the willingness of member governments to lend to it short-term. In 2010 the Executive Directors reached agreement to almost double the Fund's secure (or "quota") lending resources. The quota is the finance each member government hands over to the Fund as the Fund's own capital; the quota largely determines how much the government can borrow from the Fund and its share of votes. The 2010 agreement also included a provision to increase the share of votes going to underrepresented developing countries.

The agreement was subject to ratification in capitals. Enough other governments have ratified it for the agreement to go into effect – provided the US Congress does so too. But the Republican-controlled Congress has declined. The agreement cannot be implemented because it is subject to the US veto on supermajority decisions.

On its own the quota increase and vote redistribution could go into effect without a supermajority. But the US insisted that the quota increase be legally tied to another component, namely a change in the composition of the Board of Executive Directors, which is subject to a supermajority.

The Fund's Articles of Agreement say that the top five shareholders shall "appoint" their executive directors, while the other 19 are "elected". Appointed executive directors can represent only their own country; elected ones can – and most do – represent more than one country. The 2010 agreement called for the appointed chairs (US, Japan, UK, Germany and France) to be converted into elected chairs. This would facilitate the long-standing US and developing countries' objective of reducing the number of chairs held by western European countries (which they see as overrepresented, with eight, sometimes nine out of 24 chairs effectively controlled by western European states) and increasing the number of chairs held by developing countries.

The US insistence that the quota increase and redistribution be legally linked to the change in the Board means that it too is subject to the US veto. The US made the linkage because if the overall quota increase went ahead before the

US Congress had agreed to increase the US quota, the US vote share would fall below the 15% required for a supermajority and the US would lose its veto.

The solution to the impasse is in plain sight. The two components of the 2010 agreement should be delinked, so that the quota increase could go into effect independently of the change in Board composition. The Board could assure the US that no issue would be brought to the Board which required an 85% majority during the period when the US quota fell below 15% -- so it would continue to have a de facto though not de jure veto (until the Congress agreed to raise the US quota by enough to restore it to more than 15% of the total). However, such a delinking would require a Board Resolution, and a Board Resolution requires an 85% majority; so again is hostage to a US veto.

All roads lead back to the US veto. As long as the US keeps a veto and as long as the US Congress has power to wield the veto, US leadership in the Fund is crippled. Absent changes in the quota formula, China has the prospect of obtaining a sufficiently large share of votes to gain a veto within the next one to two decades. This prospect may be enough to induce the US to negotiate a change in rules to ensure that no single state has a blocking minority. In any case, it behoves the international community to put concerted pressure on the US administration to secure agreement from Congress. The doubling of the Fund's secure lending resources is not just a "nice to have", it is essential for the viability of the IMF and for global financial stability over the next decade.