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US Interests and the International Monetary Fund

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The United States Congress is now considering whether to raise US commitments to the International Monetary Fund (IMF). A positive decision would ratify President Obama's pledge in early April, taken with the other leaders of the G-20, to bolster the IMF as part of their cooperative response to the global economic crisis. The package of measures advanced by the G-20 leaders would triple the resources available to the Fund to $750 billion and would greatly reinforce its role in the international financial system. However, the IMF remains a controversial institution and congressional support cannot be taken for granted.

This policy brief analyzes the politics and merits of the IMF legislation before Congress. It reviews the fundamental rationale for maintaining and strengthening the institution; discusses the complex package, its elements, and their importance; examines their relationship to US interests; addresses several of the common objections to the IMF and its lending programs; reviews the politics of the congressional ratification of the last request for additional IMF funding in 1997–98; and summarizes the conclusions.

I argue that the fundamental rationale for US support for the IMF remains valid and has been dramatically bolstered by the present crisis. Although critics raise a number of objections to the IMF, their legitimate concerns can best be addressed not by weakening the institution but by creating additional safeguards. The IMF should get full credit for its reforms since the 1997–98 crisis: improved transparency, revised conditionality, and new lending facilities such as the Flexible Credit Line (FCL). The IMF reflects US economic policy preferences more faithfully than perhaps any other international organization and congressional treatment should reflect this basic convergence of interest. Failure to approve the administration's request, on the other hand, could damage financial confidence and retard global and US recovery from the crisis.

THE FUNDAMENTAL RATIONALE FOR THE IMF

If financial markets were perfect—if they incorporated all relevant information and allocated capital efficiently—the fundamental rationale for the IMF would have weakened with the increase in international capital mobility over the last few decades. During the late 1990s, some analysts expressed the view that the IMF was obsolete in an era of internationally mobile private capital: If trade deficits and emerging markets were worth financing, they argued, the private markets would do so. The present crisis shows, if there were any lingering doubts, that private financial markets suffer from imperfect information and problems of collective action. Thus they exhibit herd behavior and creditor panic (Masson and Mussa 1997). Emerging

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markets face sudden stops of capital inflows, even when their governments have been pursuing appropriate policies. The basic purpose of the IMF in today's world economy is to provide countervailing, official lending to offset these sudden stops, applying strong conditionality when policies must be adjusted and light conditionality when policies are appropriate. It thereby enables members to maintain and extend international economic openness and smoothes payments adjustment, limiting the economic and social costs of crises. The IMF is therefore complementary to, not competitive with, private financial markets.

The package of measures advanced by the G-20 leaders would triple the resources available to the Fund to $750 billion and would greatly reinforce its role in the international financial system.

The first of the Articles of Agreement of the IMF lays out the central purposes of the institution. They include: (a) promoting international monetary cooperation, (b) facilitating the "expansion and balanced growth of international trade" and "high levels of employment and real income," (c) promoting "exchange stability" and "orderly exchange arrangements," while avoiding "competitive exchange depreciation," (d) enabling members to correct payments imbalances without resorting to trade protection, and (e) reducing the duration and degree of payments imbalances. The founders of the IMF expected that these goals would be accomplished by the creation of a fund from which members could draw to finance payments imbalances. Analogous to a credit union, the IMF was to be a revolving pool of international reserves from which countries could borrow and to which they would contribute.

The IMF stood at the center of a fixed but adjustable exchange rate regime during the first 26 years of its existence. The transition to flexible exchange rates in the early 1970s raised questions about the institution's raison d'être. But the two oil shocks of that decade and the debt crisis of the 1980s demonstrated a continuing need for a robust official fund for balance of payments financing, even in the absence of an obligation to defend currency parities. With an increase in the number of members and their external obligations as a result of capital mobility, the IMF mobilized successively larger amounts of financing with each new crisis.

The IMF's near-universal membership strongly reinforces the concept of the Fund as a conduit for official finance to counteract precipitate capital withdrawal. Withdrawn capital must flow somewhere, and the recipients are in a strong position to counterbalance the private markets when appropriate with official capital inflows. Because the recipients are virtually all members of the IMF, they can best play this role through the institution.[1]

The role of the IMF extends well beyond providing official finance to include monitoring the international monetary system, fostering negotiations among members over macroeconomic policy coordination and payments adjustment, and exercising "firm surveillance" over the economic policies of members. These roles are important, especially for reducing the frequency and severity of financial crises proactively. But the ability to mobilize financial resources is central to the Fund's influence in these functions.[2]

ELEMENTS OF THE PACKAGE

President Obama's request to Congress for the IMF has four components. The first would increase the regular US quota contribution from about $56 billion to $64 billion and the second would raise an emergency line of credit to the institution from about $10 billion to roughly $110 billion. President Obama's third request is for approval of gold sales to endow an investment fund to cover a large portion of the operational expenses of the IMF, a needed innovation, and his fourth is for approval to distribute a modest amount of reserve assets issued by the IMF, called Special Drawing Rights (SDRs), primarily to countries that have not yet received them (requiring no congressional appropriation). Separately, the IMF is also planning a $250 billion general SDR allocation, which requires the US Treasury to consult with Congress but does not need congressional approval. Consider each element of the package in turn.

Quota Increase

The IMF is primarily funded through the contributions of its member states, called quotas. These are paid to the Fund in convertible and national currencies. The members review the need for an increase in overall quotas every five years, sometimes deciding to increase them. Even with occasional increases

1. Governments of receiving countries cannot automatically access these flows for reverse lending, because capital flows in through private-sector channels. But they can secure access if they wish to do so through, for example, official purchases of foreign currency to restrain appreciation of the local currency and to build international reserves.

2. The literature on the IMF and its reform is extensive. On the evolution of the institution, see Pauly (1997), Boughton (2001), and Andrews (2008). For useful reviews of the main issues of reform, see Truman (2006a and 2006b) and, for a more skeptical treatment, Woods (2006).

in quotas, however, the total size of the Fund has not kept pace with the growth of the world economy, international trade, and capital flows since its founding. As a percentage of world GDP and trade, the total size of the Fund has declined from 1 and 13 percent in 1948 to 0.6 and less than 2 percent in 2008, respectively (figure 1 and IMF 2009). This decline limits the Fund's ability to address financial crises when they arise.

The fundamental rationale for US support for the IMF remains valid and has been dramatically bolstered by the present crisis.

The present quota increase, agreed by the Board of Governors of the IMF in the spring of 2008, would raise overall quotas from about $325 billion to $357 billion (IMF 2008a).[3] The US portion of this increase is about $8 billion.[4]

In addition to establishing a country's contribution and its ability to borrow from the Fund, quotas set the voting weights of the members in the Board of Governors and the Executive Board, with a small number of additional votes distributed in equal measure to all members. As the largest contributor to the IMF, the United States wields more votes than any other single member. Because important decisions of the Fund must be approved by a supermajority of 85 percent of the votes, the United States, with 17.09 percent of total quotas and 16.77 percent of total votes, wields a veto, as would any coalition of members with more than 15 percent of the votes. The proposed quota increase would preserve the US veto.

New Arrangements to Borrow

If the quota contributions to the IMF prove insufficient to meet the demand for loans during a crisis, as happened at the end of 1998, the Fund can access a line of credit with some of its members through the New Arrangements to Borrow (NAB). Building on the General Arrangements to Borrow, a smaller facility created in the 1960s, the NAB can mobilize the reserves of 26 countries up to the amount of about $50 billion. Created in the late 1990s, the NAB has been activated once, in December 1998 to support a loan to Brazil, which was repaid in March 1999.

Shortly after taking office at the outset of the Obama administration, US Treasury Secretary Timothy F. Geithner proposed enlarging the NAB by up to $500 billion.[5] This proposal was endorsed by the G-20 leaders at the London summit in early April (see appendix, paragraph 17). Once implemented, the enlarged NAB would replace a set of bilateral credit facilities for the IMF made available by several individual countries in early 2009, including Japan and the European Union.[6] Because the US portion of the NAB has been about 20 percent, the United States would be offering up to $100 billion. This figure could decline somewhat if additional countries are brought into the NAB. However, because the NAB and quota payments are considered to be a line of credit for budgetary purposes, the impact on the federal budget would be a small fraction of this amount, a total of $5 billion spread over the next several fiscal years.[7]

The NAB increase is thus ten times larger than the proposed quota increase. But it would only be used if the quota-based resources of the IMF proved insufficient to cover the medium-term funding needs of member countries in a crisis, and then only if the lenders, including the United States, agreed to the activation. Reaching political agreement on the NAB increase is faster and easier than would be reaching agreement on a permanent increase in quotas of a similar magnitude. The G-20 leaders have called upon the members of the Fund to launch a new set of negotiations over quotas and to conclude them by January 2011 (see appendix, paragraph 20). That review should not only increase regular quotas but also redistribute them to several of the faster-growing emerging-market countries more extensively than the current quota review.

Gold Sales

In the early years of the institution, members contributed part of their IMF quotas in gold, at the rate of $35 per ounce. The

3. See also "IMF Board of Governors Adopts Quota and Voice Reforms by a Large Margin," IMF Press Release No. 08/93, April 19, 2008, available at ww.imf.org (accessed on June 9, 2009). Quotas are formally denominated in SDRs. The US dollar figures attached to them are roughly stated, because the value of the dollar changes against the SDR as the dollar fluctuates against the other currencies that make up the SDR: the Japanese yen, British pound, and the euro. The rate of exchange in late May 2009 was $1.47638 per SDR, or 0.650545 SDR per US dollar.

4. The US quota would increase SDR 4.97 billion, from SDR 37.1 billion to about SDR 42 billion.

5. "Prepared Statement by Treasury Secretary Tim Geithner in Advance of the G-20 Finance Ministers and Central Bank Governors Meeting," March 11, 2009, available at www.ustreas.gov (accessed on June 9, 2009). See also C. Fred Bergsten, "Needed: A Global Response to the Global Economic and Financial Crisis," Testimony to the Subcommittee on Terrorism, Nonproliferation and Trade, House Committee on International Relations, March 12, 2009, available at www.piie.com (accessed on June 9, 2009).

6. A number of additional countries have indicated that they would buy bonds issued by the IMF, including China for up to $50 billion and Russia for up to $10 billion.

7. These funds are provided for in the text of the IMF legislation. This procedure is a departure from standard practice since 1980; see below.

enormous increase in the price of gold since then has created an opportunity to fund new projects with the proceeds of the valuation gain. But doing so requires realizing heretofore unrealized gains through sales to either official institutions or private markets. US representatives in the Fund require the approval of Congress to accede to such sales.

Gold sales have been harnessed to an important change in the income model for the IMF. The administrative budget of the IMF has been covered until now by the proceeds of its lending. This arrangement has created two problems. First, the costs of the IMF's other activities (including surveillance, analysis, and coordination) have been born by the borrowers, which many view as inequitable. Second, the income of the Fund has been volatile while its expenses have been relatively steady. During the liquidity boom of the middle of this decade, the lack of balance-of-payments lending caused the IMF's income to fall short of its administrative expenses, forcing the Managing Director to release about 450 long-term employees, more than 17 percent of the IMF's total staff in 2007. In 2009, by contrast, its financial facilities are very much in demand and the IMF's income has been restored; only now it is short of staff. The old income model of the IMF does not match its mission.

In January 2007, the Committee to Study Sustainable Long-Term Financing of the IMF, chaired by former Bank for International Settlements (BIS) General Manager Andrew Crockett, recommended that the income model of the IMF be changed. It proposed that the IMF sell 403.3 tons (12,965,649 ounces) of gold and invest the proceeds in an investment account that would generate a return with which to cover the nonlending portion of the administrative budget.[8] This investment income plus the returns from lending would put the IMF on a solid financial footing in the report's estimation (Committee to Study Sustainable Long-Term Financing of the IMF 2007). In the spring of 2008, the Executive Board advanced this plan, proposing to the Board of Governors to sell this amount of gold (12.5 percent of the Fund's total holdings of 3,217 tons) on the open market gradually over several years, subject to approval by member governments. Assuming a gold price of $850 per ounce, the Executive Board calculated that the investment account would generate extra income of $475 million per year (IMF 2008b).

Over the fourteen months since the Executive Board's report, the price of gold has risen further, to about $950, generating a series of proposals for the extra income that would be garnered by sales. Several nongovernmental organizations have proposed using the additional proceeds for poverty alleviation and debt relief for low-income countries, proposals for which some members of Congress, such as House Financial Services Committee Chairman Barney Frank (D-MA), have some sympathy. President Obama's request to Congress includes a request to authorize the use of some of the proceeds from gold sales to assist these countries. Although the amount is unspecified in the legislation, the G-20 leaders committed themselves to devoting $6 billion to low-income countries from "additional resources" raised from gold sales "together with surplus income." The G-20 specified that this would be used for "concessional and flexible finance" over the "next 2 to 3 years" and tasked the IMF with developing concrete proposals (see appendix, paragraph 25).

8. The book value of these gold holdings is SDR 207, or about $320, per ounce.

Special Drawing Rights

Special Drawing Rights (SDRs) are an international reserve asset issued by the IMF. While not technically a claim on the IMF per se, they represent a claim on convertible currencies held in reserve by member states that have a strong balance of payments position. Members therefore hold SDRs in order to supplement their other international reserves and can convert them into dollars, euros, or other currencies when needed to temporarily finance payments deficits.[9]

The members of the IMF created the SDR in the 1960s in order to solve a problem that plagues all international monetary systems that rely on national currency as the principal reserve asset: The supply of reserves, US dollars, did not correspond to the Bretton Woods system's need for reserves. A fiat reserve asset, the SDR, was designed to supplement reserves and reduce reliance on the US dollar. This decision was made with the full support of the United States. Two separate decisions allocated a total of 21.4 billion SDRs during 1970–72 and 1979–81.

The IMF distributes SDRs to its members in two ways, through special and general allocations, both of which are part of the present package to bolster the Fund. A special allocation requires an amendment to the Articles of Agreement and thus congressional approval for US support. US support for a general allocation requires consultation with Congress but not its approval, provided that the size of the allocation falls below a particular threshold.

Special Allocation through the Fourth Amendment

None of the members of the IMF that joined since 1981 have received SDRs. This group includes all those that joined the

9. See Williamson (2009) for a discussion of the history of the SDR as well as an overview of proposals to enhance its role in the international monetary system. On US policymaking surrounding the creation of the SDR, see Odell (1982, chapter 3).

Fund following the collapse of communism and the end of the Cold War in the late 1980s and early 1990s, about one-fifth of the present membership.[10] In September 1997 the IMF Board of Governors agreed to an allocation that would bring all members' cumulative allocation of SDRs up to the percentage of their quotas (IMF 1997). Because this particular allocation would distribute SDRs disproportionately, it requires an amendment to the Articles, which in turn requires congressional approval. The Clinton administration, however, declined to submit this amendment to Congress. Other countries nonetheless proceeded with ratification, approving the amendment by 78 percent of the weighted votes of all the members. US approval, and only US approval, is required to put the special allocation into effect. It would double the amount of SDRs outstanding to 42.8 billion (roughly equivalent to $63 billion).

General Allocation

At the London summit, the G-20 leaders agreed to support a general allocation of SDRs in the amount of $250 billion equivalent (see appendix, paragraphs 5 and 19). At about SDR 163 billion, the new allocation would increase the amount of SDRs outstanding by almost a factor of four. The G-20 leaders advanced this proposal with the intent of supplementing reserves at a time when many countries are running short as a consequence of capital withdrawal during the present crisis. A large increase in SDRs outstanding would also partly obviate the need to accumulate foreign exchange reserves through currency undervaluation and thus would help to avoid the trade distortions that result from this practice.[11] This general allocation would be small in proportion to world reserves, only about 3.75 percent of the total (including gold), but would nonetheless be meaningful for several countries. This allocation is distinct from, but related to, more fundamental proposals to substitute SDRs for US dollars in a special account or to displace the dollar with the SDR as the leading international currency (Williamson 2009).[12] The US share of this allocation would be about SDR 28 billion, which would be held in the Exchange Stabilization Fund managed by the Treasury Department (Henning 1999). The Obama administration began the necessary consultations with congressional leaders in mid-April, paving the way for formal approval of the allocation in the second half of July.[13]

10. Countries that joined between 1972 and 1981 have received partial allocations.

11. See Edwin M. Truman, "How the Fund Can Help Save the World Economy," *Financial Times*, March 5, 2009, available at www.piie.com (accessed on June 9, 2009).

12. See also C. Fred Bergsten, "How to Solve the Problem of the Dollar," *Financial Times*, December 11, 2007, available at www.piie.com (accessed on June 9, 2009) and Zhou Xiaochuan, "Reform the International Monetary System," May 23, 2009, available at www.pbc.gov.cn/english (accessed on June 9, 2009).

THE INTERESTS OF THE UNITED STATES

US interests are advanced by the present legislation to increase the funds available to the IMF in at least six ways. First, by bolstering the IMF's capacity to lend to hard-hit countries, it supports US exports and jobs as well as confidence in financial markets generally. Due to decades of globalization, the prosperity of the US economy is bound closely to the prosperity of the world economy. US trade (exports plus imports) with countries that have borrowed from the IMF totals more than $400 billion per year. In 2008 US exports to emerging-market countries totaled more than $500 billion, while exports to and imports from emerging markets together totaled more than $1 trillion. Crisis lending helps to keep foreign markets open to trade and limits the potential for a collapse of currencies and growth that would harm US exports.

Second, reliance on the IMF distributes the burden of fighting crises and stabilizing economies across the membership of the institution, rather than concentrating it on the shoulders of the United States and other large countries. It avoids the tendency of smaller and medium-sized countries to slough the burden onto the largest. In the IMF, US contributions are matched more than four fold by other states, a significant bargain for the United States. Were it to mount similar rescues unilaterally, the United States would have to take on far larger commitments.

Third, although some have decried the legitimacy of the IMF, there is no question that the IMF has better standing to impose tough conditions on borrowers when needed than the United States or any other individual creditor. It is far better for a multilateral institution of which the borrower is a member to impose these conditions than to have creditor governments do so unilaterally. In addition to legitimacy considerations, unilateral lending by multiple creditors carries the danger that loans will have conflicting terms and conditions.

Fourth, maintaining a robust multilateral financial institution reduces both the need for and attractiveness of regional financial facilities. Regional financial arrangements, such as the facilities operated by the European Union and those being developed by East Asian governments, are not necessarily antithetical

13. Letters were sent to the chairman and ranking members of the Banking and Foreign Relations committees in the Senate, the Committee on Financial Services in the House, and their relevant subcommittees. See, for example, Acting Assistant Secretary for Legislative Affairs David Vandivier's letter to Christopher J. Dodd (D-CT), Chairman of the Senate Banking Committee, April 13, 2009.

to US interests (Henning 2006b and 2009). But their relationship to US interests depends on how these facilities evolve, and the United States benefits from keeping the IMF a constructive, central player in crisis resolution—one that is capable of coordinating bilateral, regional, and multilateral responses.

Fifth, a multilateral response to the crisis reinforces US foreign policy and security interests. Director of National Intelligence Dennis C. Blair recently cited the global economic crisis as the primary near-term security threat to the United States.[14] Pakistan, Turkey, Ukraine, and several other countries in Central and Eastern Europe have negotiated or are in various stages of negotiating programs with the IMF. Many others, such as South Korea, stand to benefit from confidence generated by the IMF even though they may not borrow from it.

The IMF reflects US economic policy preferences more faithfully than perhaps any other international organization.

Finally, congressional approval would bolster US leadership in combating the crisis, assuage foreign misgivings about the undeniable US role in creating it, and spur foreign governments to contribute similarly. As the principal creator of the institution, the host for its headquarters, and the wielder of the largest number of votes, the United States is the single most influential member of the IMF. The US governor holds veto power in the governing bodies over the most important decisions of the institution. Congressional rejection would undercut US leadership and greatly, perhaps fatally, weaken the US claim to its veto position within the Fund.

OBJECTIONS TO THE IMF

Critics have raised several objections to the IMF. This section considers five such arguments, often expressed by spokesmen for the political right, left, and center. These arguments revolve around the concept of moral hazard and concerns about bailing out banks, national sovereignty, policy conditionality, and the weakness of rule enforcement.

Moral Hazard

Some opponents of the IMF have argued that its existence and operations create moral hazard: recklessness on the part of private creditors when making lending decisions and on the part of borrowers when seeking financing. This argument was particularly prominent during the 1997–98 financial crisis and several subsequent blue-ribbon reports on reforming the international financial architecture. It is clear that IMF lending can have this effect in principle. In this respect, the institution is in the good company of all collective insurance arrangements that shield members from risk, both domestic and international. Municipal fire departments and automobile insurance also create moral hazard, yet we embrace them as useful institutions. The questions confronting the IMF are whether moral hazard is significant in practice and whether there are ways to contain it.

A substantial body of analysis has addressed this question. Of the two types, debtor moral hazard is the less dangerous, because the IMF can impose policy conditionality and the subsidy component of its lending is small. There is anecdotal evidence that creditor moral hazard afflicted some specific cases, notably Russia in the mid-1990s, but broader evidence that IMF lending triggers capital flows to emerging markets is distinctly lacking. After carefully reviewing this literature and recent historical cases, Roubini and Setser (2004) concluded that "the empirical record does not suggest that IMF lending, in its current form, has created widespread moral hazard."

Bailing Out Banks

Since at least the early 1980s, critics have charged that IMF lending to countries facing financial crises is tantamount to bailing out their creditors. The word "bailout" is often used loosely, but it should not be confused with public financing, especially when a coordinated response to a crisis preserves financial value for all parties. I use the term here to mean transferring risk and outright losses from the private sector to the public sector. The task is to ensure that IMF lending does not simply go toward repaying creditors ("round tripping") but benefits borrowers by smoothing adjustment and restoring access to capital markets in the near term while improving the prospects for repaying private creditors in the longer term. The record since the Mexican crisis of 1994–95 is mixed: In some cases, private banks reduced their exposure after their borrower received an IMF loan, whereas in several other prominent cases they did not. But in no case did the IMF sustain an outright loss. Moreover, private-sector "bail-ins"—creditor contributions to rescue packages through rollovers, debt exchanges, and new money—are more prevalent than commonly believed (Roubini and Setser 2004, chapter 4).

The solution to this serious problem is not to handicap the IMF with insufficient resources or to abolish it, but to bail in the creditors more consistently and forcefully. Fortunately, creditor governments and the IMF now have a broader range of

14. Walter Pincus and Joby Warrick, "Financial Crisis Called Top Security Threat to U.S.," *Washington Post*, February 13, 2009, A14.

tools with which to accomplish this than they did in previous decades. Collective action clauses (CACs) have been introduced to bond contracts to facilitate restructuring when necessary. Creditor governments have also shown a willingness to let some debtors default outright, most notably in the case of Argentina.

Analogous to a credit union, the IMF was to be a revolving pool of international reserves from which countries could borrow and to which they would contribute.

As a result of the present crisis, moreover, national governments are extending their regulatory reach over the financial sector, which empowers moral suasion over banks and other creditors to maintain their exposure to program countries. Governments are thus likely to be in a stronger position in the future to enforce private-sector bail-ins.[15]

Sovereignty

Critics on the right often warn that participation in international organizations will constrain the freedom of the United States to maneuver in international affairs. By its support for the IMF, they argue, the United States is bound to seek a working consensus with other members on the policies and direction of the institution, restricting its ability to operate independently.

Three responses counter this argument. First, the United States created and participates in the IMF because the institution broadens rather than restricts the range of options available. The United States retains the ability to act unilaterally, by lending from the Exchange Stabilization Fund or by guaranteeing private loans, for example. Second, the multilateral option is useful because it greatly enhances the resources that can be brought to bear on any given crisis and gets the rest of the international community to share in the risk of such operations. Sharing control is a natural consequence of asking others to share the risk and cost. Third, despite the fact that the United States contributes only one-sixth of the IMF's resources, it holds a veto over major decisions of the Fund and is by far the single most influential member. As observed at the outset, no international organization reflects the economic policy preferences of the United States more faithfully than the IMF.

15. Governments could broaden their range of bail-in tools further by considering proposals analogous to domestic Chapter 11 corporate bankruptcy proceedings, such as the Sovereign Debt Restructuring Mechanism (Krueger 2002).

Policy Conditionality and Program Effectiveness

The policy conditions attached to Fund lending programs have attracted criticism from both the political right and left and are perhaps the most controversial aspect of the IMF outside the United States. The main criticisms have been that the IMF attaches conditions that stifle growth, harm the fight against poverty, and are cut from a uniform template that does not take into account the unique circumstances of individual countries.[16] Martin Feldstein (1998) criticized the IMF in 1998 for including structural policy conditionality in its lending programs in Asia. Allan Meltzer advocated the abolition of policy conditions for medium-term financing in favor of short-term financing on the basis of several preconditions (International Financial Institutions Advisory Commission 2000). Joseph Stiglitz (2002) criticized the conditionality applied in the 1990s for its procyclicality, its ignorance of domestic institutions, and on the need for sequencing.

The IMF has not abandoned conditionality for several compelling reasons, but has reviewed its programs, adapted them, and introduced facilities that enable preapproved countries to borrow without having to undertake additional measures. The original reasons for adopting policy conditionality in Fund lending continue to apply. Adjustment is often necessary, and conditionality, when administered well, reduces the ultimate costs of a crisis to the borrower. Conditionality also facilitates repayment, thus protecting the Fund and its members against default, and discourages borrower moral hazard. But the IMF has acknowledged that structural conditionality can be counterproductive and has eliminated structural conditions from its recent programs (Goldstein 2001), while at the same time taking pains to protect government expenditures on social safety nets. It has also increased the participation of borrowing governments in the establishment of conditions, "ownership," which is intended to reduce the conflict between required adjustment and domestic politics (Khan and Sharma 2003).

Finally, the IMF has expanded its range of lending facilities to include loan windows that require conditionality on an ex ante rather than an ex post basis. In March the IMF launched the Flexible Credit Line (FCL), which enables countries that receive good reviews in the Article IV surveillance process to establish a line of credit in an amount of several multiples of their quota.[17] Such countries would not have to submit to new policy adjustments should they draw on this credit line. Mexico, Colombia, and Poland have signed up for the new facility. These

16. The literature on this topic is extensive. Useful overviews can be found, among other places, in IEO (2002 and 2003) and Mody and Rebucci (2006).

17. "IMF Implements Major Lending Policy Improvements," March 24, 2009, available at www.imf.org (accessed on June 9, 2009).

reforms do not satisfy all objections, but they clearly demonstrate that the IMF can review its own programs and adapt to valid criticism with some alacrity.

Enforcement Weakness

Some have argued for denying the IMF additional funding because of its alleged ineffectiveness in enforcing its norms and rules. Chinese exchange rate policy is perhaps the most frequently cited case of the institution's limitations in this regard. The Articles of Agreement prohibit currency manipulation to secure an unfair competitive advantage or that inhibits balance of payments adjustment. Although there is debate over the interpretation of this rule, Chinese currency policy during the mid-2000s represented the clearest case of a systemically important country to which this provision could apply. Yet the Executive Board of the IMF has not cited China as a country that manipulates its currency nor has it designated the renminbi as "fundamentally misaligned" in economic surveillance procedures revised in 2007. This reticence frustrates independent analysts and, more importantly, members of Congress who have inveighed against renminbi undervaluation for some time.

As the largest contributor to the IMF, the United States wields more votes than any other single member.

Nonetheless, withholding support in order to incentivize the IMF to enforce hard rules would be misguided and counterproductive for several reasons. It is the cold reality of international politics that international organizations rarely enforce hard rules on powerful members. An expectation that they might do so confuses the principal-agent relationship involved: International institutions are the agents of the governments that create them, not the other way around. When the rules of an institution conflict with the core interests of a major state, typically it is the rules that give way rather than state interests. The reasons for this are several, including the fact that the potential target, in this case China, sits on the governing bodies of the institution, in this case the Executive Board, and is therefore in a position to block reprimands or sanctions.[18] Attributing the moral force and effectiveness of domestic law to international norms and rules is to fundamentally misunderstand international relations. Those who had hoped that the IMF could reverse Chinese undervaluation by rule enforcement and who are now disillusioned have been the victims of inflated expectations (Henning 2006a).

Instead, international organizations are useful because, when states' interests coincide, they facilitate exchange of information, provide analysis, broker Pareto-improving bargains among member states, and monitor compliance.[19] In addition to providing financing to combat financial crises, the IMF has been manifestly useful in these roles. It would certainly be inconsistent for Congress to attach unrealistic or extraneous conditions on US support or to withhold support entirely and then to later bemoan the weakness of the institution. Those who want a stronger IMF should support it financially and politically.

By realistic standards for international organizations, the IMF has been very effective in its roles generally. It is precisely this effectiveness that attracts politicization, as governments, interest groups, and nongovernmental organizations see it as a useful vehicle for other objectives. If it were not effective, it would not be controversial.

US POLITICS AND THE ROLE OF CONGRESS

Congress plays a central role in US policy toward the IMF. US approval of the most important decisions of the Fund—amendments to the Articles of Agreement, increases in quota contributions, borrowing arrangements, and gold sales, among others—must be approved by Congress. Although the IMF advances US interests in several ways, congressional review has sometimes lacked strength and focus, and its support has not always been reliable.

There are several reasons for this disconnect between overall national interest and Congress's treatment of the IMF. First, while IMF crisis lending buoys the US economy, that relationship is indirect and the benefits are broadly dispersed. The benefits cannot easily be captured by interest groups or corporations. Interest groups are thus unlikely to make support for the IMF a priority on their political agenda for policy activism in Washington. In this respect, the IMF and international monetary policy generally contrast with the interest group politics of trade policy, where specific firms and sectors can expect to capture benefits from trade measures (Gowa 1988).

Members of Congress are similarly unlikely to give the IMF top priority on their legislative agenda. Unlike domestic financial institutions, the IMF cannot lend to or manage the assets

18. Dispute settlement under the World Trade Organization has been relatively successful because decisions are generally narrower in scope, impinge less on core interests, and are ultimately enforced by the ability of aggrieved members to take retaliatory action. These qualities are not easily transferred to the IMF.

19. As conceptualized by the institutionalist approach to international relations. See, for example, Keohane (1984).

of their constituents. Unlike federal agencies, the IMF does not serve the constituents in their states or districts directly. Within Congress, moreover, responsibility for legislation and oversight is fragmented, with the banking, international relations, and appropriations committees of both houses involved. So, as in the case of other international institutions, few members of Congress are willing to champion the IMF; it is "orphaned."

Reliance on the IMF distributes the burden of fighting crises and stabilizing economies across the membership of the institution, rather than concentrating it on the shoulders of the United States and other large countries.

Finally, Congress is wary of letting the authority that it jealously guards in disputes with the executive branch over domestic matters slip away under the guise of international cooperation.[20] Outright opposition to the IMF in Congress tends not to be broad and intense, but neither is support a high priority for most members.

The Treasury, which formulates US policy in the IMF, is the main advocate of legislation that supports the institution. It may rely on the White House to advance legislation on Capitol Hill or it may take the lead directly, depending on the particular circumstances. When quota reviews or amendments come onto the IMF's agenda, senior Treasury officials consider the attitudes of Congress and whether the measure is worth the effort of seeking congressional approval before giving a green light in the governing bodies of the IMF. After submitting legislation to the Hill, Treasury will lead an effort to mobilize support among other executive agencies, such as the Commerce, State, and Defense departments; private interest groups; and opinion leaders. The mobilization of interest groups in support of the original Bretton Woods Agreements Act of 1945 serves as the classic example of Treasury's success in building a coalition. But the coalitions thus created tend to be shifting and unstable; the task of renewing a supportive coalition has become progressively more demanding with time. Recent administrations have thus avoided seeking congressional approval for IMF legislation unless it was urgent. Recent requests have tended to coincide with major international financial crises (Lavelle forthcoming). Of the three quota increases since the advent of the Reagan administration, one accompanied the Latin American crisis of the early 1980s and another the Asian financial crisis of 1997–98. The third coincided with the end of the Cold War, which presented exceptional arguments in favor of multilateral financial cooperation (table 1).

The last request for congressional approval of IMF funding came during the Asian financial crisis of 1997–98. Beginning in July 1997 in Thailand, this crisis engulfed the region in autumn of that year and had spread globally by mid-1998. It caused output declines in affected countries substantially exceeding any previous postwar recession. The Asian crisis closely followed the Mexican peso crisis of 1994–95, the rescue for which prompted congressional objections, investigations, and temporary constraints on the use of the Exchange Stabilization Fund (Henning 1999). The international financial community responded by creating the New Arrangements to Borrow, which had yet to receive congressional approval when the crisis in Thailand struck.

Aware that the IMF had committed or was about to commit $53.5 billion in a span of three months as part of a set of rescue packages totaling more than $100 billion, the Clinton administration requested approval of the NAB in November 1997. In late December President Clinton requested congressional approval of the US contribution to the $87.5 billion quota increase as well and called for full funding in his State of the Union Address in late January 1998. The total US commitment would be about $17.9 billion, $14.5 billion for the quota increase and $3.4 billion for the NAB, to be authorized and appropriated but involving no net outlay and with no consequences for the budget deficit.

Congressional consideration of these measures was lengthy and tortured, notwithstanding the proliferation of the crisis and the drain of IMF resources. The Senate Foreign Relations Committee and the House Financial Services Committee, among others, held hearings at which administration officials and private-sector representatives testified in favor of IMF funding. These witnesses included Treasury Secretary Robert E. Rubin, UN Ambassador Bill Richardson, Secretary of Defense William Cohen, Federal Reserve Chairman Alan Greenspan, and US Trade Representative Charlene Barshefsky. Interest-group representatives included officials from the National Association of Manufacturers, the American Farm Bureau, and individual companies, such as Boeing. The US Chamber of Commerce organized a coalition of 300 members in support. Eighty-eight business leaders signed an open letter to Congress with former Presidents Jimmy Carter and Gerald Ford (Scott and Carter 2005).

But other interest groups and experts raised obstacles to the legislation. Labor-union representatives proposed tying

20. Lavelle (forthcoming) offers the most comprehensive account available of the US politics of the Bretton Woods institutions.

IMF funds to institutional reforms and the improvement of labor conditions in program countries. Former Secretary of State, Treasury, and Labor, and former Director of the Office of Management and Budget (OMB) George Shultz advocated the abolition of the IMF, as did presidential candidate Steve Forbes. The *Wall Street Journal* opposed the funding request, and Jeffrey Sachs and George Soros, among others, criticized the conditionality applied to IMF loans (Scott and Carter 2005).

Although some have decried the legitimacy of the IMF, there is no question that the IMF has better standing to impose tough conditions on borrowers when needed than the United States or any other individual creditor.

Most members of Congress did not oppose the IMF or its funding outright; instead they sought to use the administration's request as a vehicle for their own agendas. Senator Jesse Helms (R-NC), chairman of the Senate Foreign Relations Committee, attached his plan to reorganize US foreign assistance organizations to the IMF funding bill. In the House, Representative Christopher Smith (R-NJ) instead attached his plan to block international aid agencies that received US funds from advocating abortion in family planning, the so-called Mexico City provision. The two provisions competed with one another and President Clinton threatened to veto legislation with the Mexico City provision. After passing their respective bills, the House and Senate were at an impasse (Lavelle forthcoming, Sanford forthcoming, and Scott and Carter 2005).

Meanwhile, the financial crisis spread to Russia, which defaulted on $17 billion of government debt when the IMF refused a second program in the summer of 1998. This caused a "flight to liquidity" that trapped the large hedge fund Long Term Capital Management (LTCM), requiring a rescue organized by the Federal Reserve and eventually three, rapid, quarter-point cuts in US interest rates. As the crisis deepened, administration officials, congressional leadership, and the bill's managers intensified negotiations. A bargain was finally struck in conference committee on October 7 that kept the Helms amendment, struck the Mexico City provisions, stipulated a substantial list of reforms for the Fund, and established an advisory committee to review the institution. The final bills were passed at the end of the legislative session and signed into law on October 21, 1998.

The 1997–98 case illustrates several enduring patterns in the congressional politics of the IMF.[21] First, opposition often comes from a coalition of strange bedfellows that is from the outer extremes of both parties. Second, support, while it tends to come from the center, is usually moderate in intensity rather than strong. Third, as many members' second or third priority, IMF legislation can often be used as a vehicle for members' top priorities. Fourth, party control of the two branches can be critical; without a majority in Congress, the Clinton administration had difficulty imposing discipline on the attachment of extraneous amendments to the IMF legislation.[22]

Finally, the case speaks to the relationship between congressional action, or inaction in this case, and international financial markets. At the end of July 1998, Treasury officials estimated that the IMF held $3–5 billion available for new lending (Blustein 2001, 293–94). Its quota increase could not go into effect until Congress acceded to the US contribution. One has to ask to what extent the congressional delay contributed to the flight to liquidity in the wake of the Russian default. Although it would be difficult to demonstrate the counterfactual case conclusively, more expeditious congressional passage of the IMF legislation might have boosted confidence and helped to contain capital flight from emerging markets in the late summer and autumn of 1998.

The counterfactual 1998 scenario is particularly relevant now, as Congress considers whether to act on the Obama administration's request quickly or to deliberate at greater length. As of May 21, 2009, the IMF posts a one-year forward commitment capacity of SDR 32.5 billion, to which we could add SDR 34 billion under the NAB and a $100 billion credit line from Japan.[23] Given the magnitude of the present crisis, one should ask what the impact of a worsening of the crisis might be on international markets in the absence of expeditious passage of the IMF legislation.

Recent objections to the US contribution in Congress have centered on budget accounting, transparency, and the approval process. The approval process and budgetary treatment have varied substantially over the history of US participation in the IMF (Sanford and Weiss 2009). Between 1980 and 1998, IMF contributions were authorized and appropriated but not scored as an outlay because the United States receives an equivalent claim on the IMF that it can cash at any time. President Obama's OMB Director, Peter Orszag, has argued that appro-

21. See also Broz and Hawes (2006) and Broz (2008), which analyze the determinants of congressional voting on the IMF.

22. The Carter administration faced similar difficulty even with Democratic dominance in Congress but did not have a crisis of similar magnitude to support an argument for party discipline.

23. "IMF Financial Activities—Update May 21, 2009," available at www.imf.org (accessed on June 9, 2009).

priation was inconsistent with the absence of an outlay.[24] A *Wall Street Journal* editorial decried the administration's approach by saying, "it's all opacity all the time."[25] But the budget committees of both houses decided to apply the Federal Credit Reform Act of 1990, under which only risk-weighted exposure would be appropriated, a Solomon-like solution. The Congressional Budget Office thus scored the $100 billion line of credit through the NAB and the $8 billion quota increase together as $5 billion for appropriation. The $5 billion would be entered as outlays in the federal budget, probably in increments spread out over the next several fiscal years (Sanford and Weiss 2009).[26] Given that the United States has not lost a penny on its contribution to the IMF over the 65-year history of the institution and that the IMF remains a preferred creditor, even this limited scoring is very conservative. US government exposure to the IMF contrasts sharply with its exposure in the rescue of the domestic banking and financial system, such as through the Troubled Asset Relief Program (TARP), on which large losses can be expected.

Those who want a stronger IMF should support it financially and politically.

CONCLUSION

This analysis has reviewed the merits, politics, and policy process surrounding President Obama's request for congressional approval of substantially increased funding for the IMF. It has surveyed the basic rationale for the IMF, the elements of the present package of reforms, and some of the most common objections to the institution. I have argued that the IMF is complementary to rather than in conflict with the expansion of private capital markets. The institution is needed to stabilize markets and to provide international public goods now more than ever. For these reasons, the G-20 leaders turned mainly to the IMF in their efforts to resolve the present global economic crisis. By fostering stability and openness abroad, strengthening the IMF advances the economic and financial interests of the United States.

Congressional approval of these measures is also essential for maintaining US leadership in international economic relations and foreign affairs generally. Congress should not take US influence within the IMF or other nations' willingness to support it for granted. Congressional support would sustain the leadership that the United States has shown since it led in the creation of the IMF in 1944. Conversely, failure to support the institution during this financial crisis would not only jeopardize the global and US economic recoveries but also damage US influence. The United States might be able to sustain its veto within the IMF as a legal matter, but congressional rejection would be very costly for the United States in diplomatic terms and could possibly render the veto position politically unsustainable.

24. David Rogers, "Orszag's Power Play," *Politico*, April 22, 2009.

25. *Wall Street Journal*, "What's Another $108 Billion?" May 18, 2009.

26. See also Douglas Elmendorf, "Budget Implications of U.S. Contributions to the International Monetary Fund," Congressional Budget Office Director's Blog, May 19, 2009, available at http://cboblog.cbo.gov (accessed May 19, 2009).

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APPENDIX

Excerpts from the G-20 London Summit Leaders' Statement, "The Global Plan for Recovery and Reform," April 2, 2009, available at www.g20.org (accessed on June 9, 2009).

5. The agreements we have reached today, to treble resources available to the IMF to $750 billion, to support a new SDR allocation of $250 billion, to support at least $100 billion of additional lending by the MDBs, to ensure $250 billion of support for trade finance, and to use the additional resources from agreed IMF gold sales for concessional finance for the poorest countries, constitute an additional $1.1 trillion programme of support to restore credit, growth and jobs in the world economy. Together with the measures we have each taken nationally, this constitutes a global plan for recovery on an unprecedented scale.

Strengthening Our Global Financial Institutions

17. Emerging markets and developing countries, which have been the engine of recent world growth, are also now facing challenges which are adding to the current downturn in the global economy. It is imperative for global confidence and economic recovery that capital continues to flow to them. This will require a substantial strengthening of the international financial institutions, particularly the IMF. We have therefore agreed today to make available an additional $850 billion of resources through the global financial institutions to support growth in emerging market and developing countries by helping to finance counter-cyclical spending, bank recapitalisation, infrastructure, trade finance, balance of payments support, debt rollover, and social support. To this end:

    - we have agreed to increase the resources available to the IMF through immediate financing from members of $250 billion, subsequently incorporated into an expanded and more flexible New Arrangements to Borrow, increased by up to $500 billion, and to consider market borrowing if necessary; and
    - we support a substantial increase in lending of at least $100 billion by the Multilateral Development Banks (MDBs), including to low income countries, and ensure that all MDBs have the appropriate capital.

18. It is essential that these resources can be used effectively and flexibly to support growth. We welcome in this respect the progress made by the IMF with its new Flexible Credit Line (FCL) and its reformed lending and conditionality framework which will enable the IMF to ensure that its facilities address effectively the underlying causes of countries' balance of payments financing needs, particularly the withdrawal of external capital flows to the banking and corporate sectors. We support Mexico's decision to seek an FCL arrangement.

19. We have agreed to support a general SDR allocation which will inject $250 billion into the world economy and increase global liquidity, and urgent ratification of the Fourth Amendment.

20. In order for our financial institutions to help manage the crisis and prevent future crises we must strengthen their longer term relevance, effectiveness and legitimacy. So alongside the significant increase in resources agreed today we are determined to reform and modernise the international financial institutions to ensure they can assist members and shareholders effectively in the new challenges they face. We will reform their mandates, scope and governance to reflect changes in the world economy and the new challenges of globalisation, and that emerging and developing economies, including the poorest, must have greater voice and representation. This must be accompanied by action to increase the credibility and accountability of the institutions through better strategic oversight and decision making. To this end:

    - we commit to implementing the package of IMF quota and voice reforms agreed in April 2008 and call on the IMF to complete the next review of quotas by January 2011;
    - we agree that, alongside this, consideration should be given to greater involvement of the Fund's Governors in providing strategic direction to the IMF and increasing its accountability;
    - we commit to implementing the World Bank reforms agreed in October 2008. We look forward to further recommendations, at the next meetings, on voice and representation reforms on an accelerated timescale, to be agreed by the 2010 Spring Meetings;
    - we agree that the heads and senior leadership of the international financial institutions should be appointed through an open, transparent, and merit-based selection process; and
    - building on the current reviews of the IMF and World Bank we asked the Chairman, working with the G-20 Finance Ministers, to consult widely in an inclusive process and report back to the next meeting with proposals for further reforms to improve the responsiveness and adaptability of the IFIs.

Ensuring a Fair and Sustainable Recovery for All

25. We are determined not only to restore growth but to lay the foundation for a fair and sustainable world economy. We recognise that the current crisis has a disproportionate impact on the vulnerable in the poorest countries and recognise our collective responsibility to mitigate the social impact of the crisis to minimise long-lasting damage to global potential. To this end:

    - we have committed, consistent with the new income model, that additional resources from agreed sales of IMF gold will be used, together with surplus income, to provide $6 billion additional concessional and flexible finance for the poorest countries over the next 2 to 3 years. We call on the IMF to come forward with concrete proposals at the Spring Meeting...

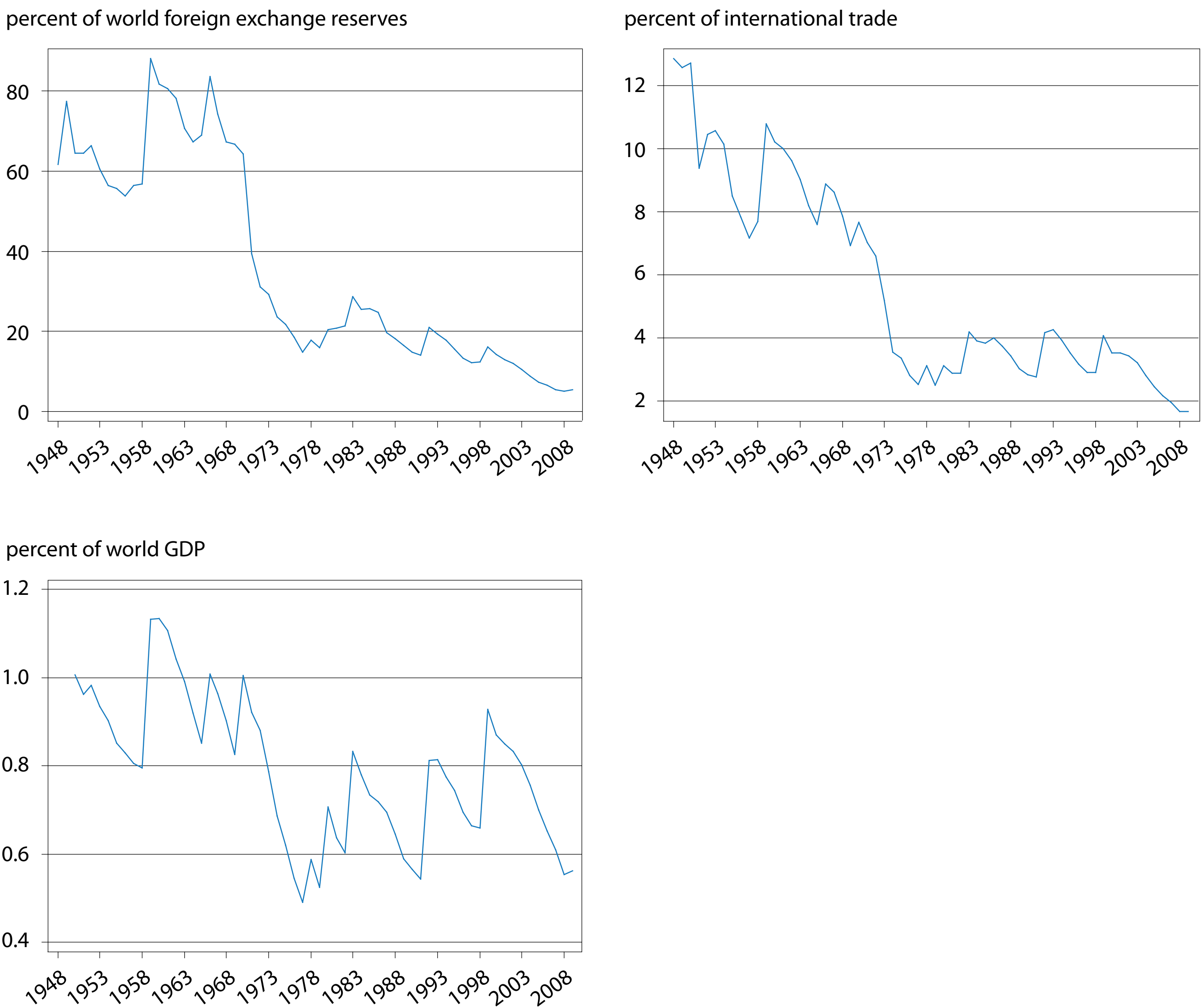
Table 1 Congressional approval of IMF measures

Event	IMF Board of Governors resolution	Overall increase (billions of US dollars)[a]	US contribution (billions of US dollars)	Congress	Signed into law
The Bretton Woods Agreements Act	July 22, 1944	8.46	2.75	79th	July 31, 1945
1st General Quota Review (1950)	No increase proposed	–	–	81st	–
2nd General Quota Review (1955)	No increase proposed	–	–	84th	–
3rd General Quota Review	February 2 and April 6, 1959	4.76	1.375	86th	June 17, 1959
General Arrangements to Borrow (GAB)	January 5, 1962	6	2	87th	June 19, 1962
4th General Quota Review	March 31, 1965	4.67	1.035	89th	June 2, 1965
1st Amendment to the Articles of Agreement	May 31, 1968	9.5[b]	2.3[b]	90th	June 19, 1968
5th General Quota Review	February 9, 1970	7.08	1.54	91st	December 30, 1970
Par Value Modification (1972)	–	–	0.525[c]	92nd	May 18, 1972
Par Value Modification (1973)	–	–	0.606[c]	93rd	October 26, 1973
6th General Quota Review and the 2nd Amendment to the Articles of Agreement	March 22, 1976	13.44	1.96	94th	October 19, 1976
Supplementary Financing Facility ("Witteveen Facility")	August 29, 1977	10.5	1.87	95th	October 10, 1978
7th General Quota Review	December 11, 1978	28.00	5.46	96th	October 7, 1980
8th General Quota Review	March 31, 1983	27.54	5.68	98th	November 30, 1983
GAB Increase	February, 1983	12.19	2.45	98th	November 30, 1983
Interest Subsidy Account of the Enhanced Structural Adjustment Facility	December 29, 1987	–	0.15	101st	December 19, 1989
9th General Quota Review and the 3rd Amendment to the Articles of Agreement	June 28, 1990	84	12.14	102nd	October 24, 1992
10th General Quota Review (1995)	No increase proposed	–	–	104th	–
New Arrangements to Borrow (NAB)	January 27, 1997	28.05	3.4	105th	October 21, 1998
11th General Quota Review	January 30, 1998	87.5	14.55	105th	October 21, 1998
12th General Quota Review (2003)	No increase proposed	–	–	108th	–
13th General Quota Review (2008)	No increase proposed	–	–	110th	–
Ad Hoc Quota Increase	April 28, 2008	27.5	8	111th	Pending
NAB Increase	April 2, 2009	450	100	111th	Pending

a. Until 1972 IMF resources were denominated in US dollars; subsequently, they are denominated in SDR. After 1972 US dollar amounts are calculated using the average USD/SDR exchange rate for that year.
b. This is a credit from the IMF to the members and to the United States, respectively.
c. These amounts were disbursed in 1975 as a one-time maintenance-of-value payment to the IMF.

Sources: International Monetary Fund; Library of Congress; LexisNexis Congressional; Horsefield (1969); CBO (1978); de Vries (1986).

Figure 1 IMF quotas as a percentage of world reserves, trade, and GDP, 1948–2008



Notes: For 2009 total IMF quotas include the ad hoc increase of 11.5 percent agreed in 2008; 2009 foreign exchange reserves data are as of March 2009; 2009 GDP and international trade are IMF WEO estimates; nominal GDP for 1950–1960 imputed based on Maddison (2009); international trade in services data available from 1980; before 1980, trade in services calculated using growth rates for trade in goods.

Sources: IMF, *International Financial Statistics*; IMF, *World Economic Outlook (WEO)*; World Bank, *World Development Indicators*; Maddison (2009).