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POLICY BRIEF

17-10 International Financial Cooperation Benefits the United States

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The financial crisis of 2007–09 became a global conflagration because of an economic fact of life: the interconnectedness of many countries' economies and financial systems. To contain and stabilize these interwoven global financial systems and avert future crises thus requires international cooperation, preferably with American leadership. Such cooperation rests on two pillars: crisis prevention and crisis management. The Trump administration's policies in these areas are unclear. But early indications are that there is reason to be concerned over future US commitment to international regulations and institutions that would prevent and manage the inevitable occurrence of future crises.

An indication of the administration's less than positive approach came in President Donald Trump's inaugural address: "Every decision on trade, on taxes, on immigration, on foreign affairs, will be made to benefit American workers and American families." On February 24, he told the Conservative Political Action Committee, "Global cooperation, dealing with other countries, getting along with other countries is good, it's very important. But there is no such thing as a global anthem, a global currency or a global flag. This is the United States of American that I'm representing."[1] Such words suggest a possible shift away from the approach toward international agreements that has been a central pillar of American foreign policy since the end of World War II, driven by a cosmopolitan view (Weisman 2016) that what is good for the world is good for the United States. In recent decades, US administrations have adjusted the approach to adopt a "communitarian" ideal of using international agreements to promote

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US interests broadly defined—for example, by pressing for financial openness agreements that would help US-based companies to compete in foreign markets. In that sense, the Trump administration's "America first" approach might build on recent trends. But US interests might be more narrowly delineated.

The evidence is admittedly mixed. On January 30, President Trump signed an executive order on financial regulations,[2] declaring that the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act)

1. White House, "Remarks by President Trump at the Conservative Political Action Conference," press release, February 24, 2017, https://www.whitehouse.gov/the-press-office/2017/02/24/remarks-president-trump-conservative-political-action-conference (accessed March 2, 2017).

2. Glenn Thrush, "Trump Vows to Dismantle Dodd-Frank 'Disaster,'" *New York Times,* January 30, 2017, https://www.nytimes.com/2017/01/30/us/politics/trump-dodd-frank-regulations.html?_r=0 (accessed on February 22, 2017).

"is a disaster" and that his administration planned to "do a big number" on the 2010 law, a cornerstone of the post-crisis efforts to reform the US financial system. More significantly from the global perspective, the Dodd-Frank Act was the cornerstone of more intensive US cooperation with governments and regulatory authorities around the world to strengthen the international financial system in the wake of the global financial crisis. Repealing Dodd-Frank, as many Republicans in Congress say they want, could—with administration backing—weaken the norms and standards that have been developed in recent years to support international financial stability and crisis prevention.

Another possible signal of administration intentions occurred on January 25, with reports of an impending White House executive order calling for a large reduction of US funding of international organizations and a review of all treaties and, by implication, international agreements.[3] As of this writing, no such executive order has been issued and the administration's budget has not yet been released. But considering difficulties in recent years in getting Congressional approval of funding for the International Monetary Fund (IMF), and rampant skepticism on Capitol Hill over US participation in institutions promoting international economic and financial cooperation, concerns that the tools of crisis management will be adversely affected are not unwarranted.

On the other hand, the US Treasury's account of Secretary Steven Mnuchin's conversation on February 21 with IMF Managing Director Christine Lagarde is encouraging.[4] The press release describing that meeting recognizes the role of the IMF in crisis prevention and management as well as its role in encouraging sound economic policies in member countries, including exchange rate policies.

International financial crises have in the past caused policymakers to change their minds about the need for intervention by global institutions. Before they took office in 2001, top economic policymakers in the administration of President George W. Bush criticized IMF actions in the East Asian financial crisis of the late 1990s, only to adopt similar policies when crises arose on their watch. But the rest of the world should not count on a *deus ex machina*. Rather, the major countries with records of cooperating with Washington must recognize the risks posed to global financial stability from ambiguous statements from the Trump administration. Its allies should seek to convince the administration that international financial cooperation is in the interests of the United States, and, failing that, be prepared to go it alone largely without traditional US support.

CRISIS PREVENTION

The Group of Twenty (G-20) leaders have made strengthening global financial stability through cooperation on financial reforms their major focus since their first meeting in Washington in November 2008. At their second meeting in London in April 2009, the G-20 expanded membership in the Basel Committee on Banking Supervision and transformed the Financial Stability Forum into the Financial Stability Board (FSB), also with an expanded membership. The Trump administration will have an early opportunity to change the US representation on the Basel Committee and the Financial Stability Board (box 1) and thereby influence their ongoing agendas for global financial stability.

In the case of the Basel Committee agenda, the final chapter of the reforms known as Basel III has not been agreed. Unless agreement can be reached, the entire structure may collapse or suffer substantial erosion. If new capital standards are not uniform, the Committee's monitoring of their implementation will produce ambiguous results at best.

In the case of the FSB, its 10-item work plan[5] ranges from reviewing current vulnerabilities in the global financial system and the implementation of reforms agreed since 2008 to issues associated with financial technology. The work of the FSB and associated standard-setting bodies is focused on agreeing on a common set of standards applying uniformly to all institutions that have the potential to adversely affect global financial stability. To this end, the FSB has identified 30 large, internationally active banks as Global Systemically Important Banks (G-SIBs) that should be subject to additional capital and other requirements, such as resolution plans. Eight of them are US institutions, and all of them have operations in the United States, which implies that the strength or weakness of the supervision and regulation in their home countries can affect the stability of the US financial system. The FSB has also identified nine Global Systemically Important Insurers (G-SIIs) of which three are US institutions. See Sheets (2017) for a detailed analysis of the US role in the FSB and the associated benefits for the United States.

3. Max Fisher, "Trump Prepares Orders Aiming at Global Funding and Treaties," *New York Times,* January 25, 2017, https://www.nytimes.com/2017/01/25/us/politics/united-nations-trump-administration.html (accessed on February 22, 2017).

4. US Department of the Treasury, "Readout from a Treasury Spokesperson of Secretary Mnuchin's Call with International Monetary Fund Managing Director Christine Lagarde," press release, February 21, 2017, https://www.treasury.gov/press-center/press-releases/Pages/sm0010.aspx (accessed on February 22, 2017).

5. FSB, *Financial Stability Board Agrees 2017 Workplan,* November 17, 2016, http://www.fsb.org/2016/11/financial-stability-board-agrees-2017-workplan/ (accessed on January 31, 2017).

Box 1 The Basel Committee and the Financial Stability Board: Opportunities to change US representation

The Basel Committee on Banking Supervision has revamped global banking standards, particularly with respect to increasing the quality and quantity of bank capital, in a set of reforms known as Basel III. The Committee now includes 45 institutions from 28 countries. Four US institutions are members: the Board of Governors of the Federal Reserve System, the Federal Reserve Bank of New York, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation (FDIC).

The comptroller of the currency is likely to be replaced early in the Trump administration. The comptroller is a member of the four-person board of the FDIC; the term of the chair of the FDIC ends this November, that of the vice chair ends next November, and the fourth member is the director of the Consumer Financial Protection Bureau, which could be abolished as part of legislation replacing the Dodd-Frank Act. If as widely expected the Trump administration appoints a vice chair for supervision at the Federal Reserve Board from among the governors, that person will have a substantial influence on the Federal Reserve's posture at meetings of the Basel Committee. There are currently three vacancies on the Board, and one of the new governors is likely to be nominated as vice chair for supervision.

The Financial Stability Board's (FSB) mandate is to promote international financial stability by coordinating national financial authorities and international standard-setting bodies and by encouraging coherent implementation of these policies across sectors and jurisdictions. The FSB has representatives from 48 institutions in 28 countries (including the European Union) plus representatives from the Bank for International Settlements, the IMF, and the World Bank, and representatives from the international standard-setting bodies for banking (the Basel Committee), payments, insurance, accounting, and securities.

As with the Basel Committee, the Trump administration will have an opportunity soon to change US representation on the FSB. One representative is from the Treasury Department, which has a new secretary who soon will have a new team. One is from the Securities and Exchange Commission (SEC), which has three vacancies, an acting chair, and one commissioner whose term ends this August. The third US representative on the FSB is from the Federal Reserve Board, which has three vacancies.

More important than the ongoing work of these organizations will be the Trump administration's approach to financial regulation. On February 3, President Trump issued an executive order on "core principles for regulating the United States Financial System."[6] The executive order itself does not mention the Dodd-Frank Act, but in comments to business executives the same day reported in the press, President Trump said "we expect to be cutting a lot out of Dodd-Frank."[7]

The Dodd-Frank legislation was crafted in parallel with the initial work on Basel III and other international financial system reforms. The reforms called for in the Dodd-Frank Act, Basel III, and similar agreements are substantially the same. The question is whether new US financial legislation and regulation with cross-border implications will continue to be broadly similar to reforms in other countries.

A thorough reform and replacement of the Dodd-Frank Act will involve the Congress. A 2016 proposal to reform the US financial regulatory system—the Financial Choice Act crafted by Republicans on the House Committee on Financial Services[8]—provides a hint of what the Trump administration and Republican majorities in the Congress might seek to enact. That proposed legislation offered banking institutions a choice between having a leverage ratio of 10 percent of total assets in return for relief from many of the regulations embodied in the Dodd-Frank Act or remaining under all its provisions.[9] Many smaller US banks would be expected to make this election. It is less clear that larger banking organizations would. However, even for these latter institutions, the proposed legislation would scale back some of the Dodd-Frank Act provisions, for example with respect to living wills and stress tests.

It is unclear how rolling back parts of the Dodd-Frank Act would affect foreign banks or the framework of coopera-

6. "Presidential Executive Order on Core Principles for Regulating the United States Financial System," White House Press Office, February 3, 2017, https://www.whitehouse. gov/the-press-office/2017/02/03/presidential-executive-order-core-principles-regulating-united-states (accessed on February 22, 2017).

7. "'We expect to be cutting a lot out of Dodd-Frank,' Trump promises," *Washington Post*, February 3, 2017, https://www.washingtonpost.com/video/politics/we-expect-to-be-cutting-a-lot-out-of-dodd-frank-trump-promises/2017/02/03/dea4e7e4-ea28-11e6-903d-9b11ed7d8d2a_video.html (accessed on February 24, 2017).

8. A new version of this proposal is expected to be introduced in the near future.

9. Under Basel III, banks are required to have a leverage ratio of at least 3 percent. Under US regulations, US G-SIBs are required to have leverage ratios of at least 6 percent.

tion established by the Basel Committee and the FSB over the past eight years. For example, raising the minimum size of banks subject to tighter and more comprehensive regulations from $50 billion in assets to, say, $100 billion or $250 billion probably would not affect the international playing field. Easing compensation regulation would not have significant direct consequences. Replacing or scaling back the role of the Consumer Financial Protection Bureau is unlikely to trigger a pushback from other countries. More problematic from an international perspective would be changing or scaling back other components of the Dodd-Frank Act such

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as capital regulations, stress testing and capital planning, liquidity regulation, resolution authority, and the Volcker Rule on trading activities of banks.[10] If the United States dismantles many of the new features of its regulatory framework, it can expect similar, if not more aggressive, moves in other countries. Consequently, the US financial system will be less safe. The United States benefits from a level playing field as well as common global protections from crises.

The authors of the Financial Choice Act clearly take a dim view of the Basel processes. The description of a provision that would abolish the Office of Financial Research (OFR) in the Treasury Department states "The OFR is emblematic of the trend toward a homogenized, 'one-world' view of risk management that also informs the work of the Basel Committee on Banking Supervisions, as well as many other post-crisis regulatory initiatives" (HCFS 2016, 95).

More recently, Congressman Patrick McHenry, vice chairman of the House Financial Services Committee, sent a cease-and-desist letter to Federal Reserve Chair Janet Yellen on January 31 calling on the Federal Reserve to stop participating in forums such as the FSB and Basel Committee until the objectives of the new administration are set. On international cooperation in this area, he wrote:

> The secretive structures of these international forums must also be reevaluated. Agreements like the Basel III Accords were negotiated and agreed by the Federal Reserve with little notice to the American public, and were the result of an opaque, decision-making process. The international standards were then turned into domestic regulations that forced American firms of various sizes to substantially raise their capital requirements, leading to slower economic growth here in America.[11]

McHenry is only one member of the House of Representatives, though an influential member. His skepticism about the current US financial regulatory regime is likely to echo throughout the Congress and the executive branch. Indeed, in a February 9 letter to Chair Yellen, Senator Pat Toomey, chair of the Subcommittee on Financial Institutions and Consumer Protection and member of the Senate Committee on Banking, Housing, and Urban Affairs, called upon the Federal Reserve to terminate its Comprehensive Capital Analysis and Review (CCAR process) and instead rely on banks' internal stress tests. Since the global financial crisis, stress tests designed by regulators, rather than by financial institutions themselves, have become a powerful supervisory tool used with substantial success in many jurisdictions (Goldstein 2017).

It is also reasonable to be concerned that the Trump administration will take a negative stance toward international cooperation on global financial stability via the FSB, Basel Committee, and similar mechanisms. In the executive order issued on February 3, one of the core principles guiding regulation of the financial system is "(e) advance American interests in international financial regulatory negotiations and meetings." And the report that the secretary of the treasury must make to the president with 120 days is to include "the extent to which existing laws, treaties, regulations, guidelines, reporting and record keeping requirements, and other government policies promote the Core Principles and what actions have been taken, and are currently being taken, to promote and support the Core Principles."[12] The implicit criticism of international agreements in this area could have a chilling effect on ongoing international discussions. Crisis prevention in promoting financial stability would be set back

10. Robin Greenwood, Samuel G. Hanson, Jeremy C. Stein, and Adi Sunderam (2017) favor reform of the Dodd-Frank Act to loosen the supplementary leverage ratio, which they assert without citing evidence is pushing banks away from low risk activities and distorting the market for US Treasury securities. In an environment in which other banking systems are resisting any leverage requirements, the signal sent by a US reduction in its requirements could well be misinterpreted.

11. Congressman Patrick McHenry, letter to Federal Reserve Chair Janet Yellen, January 31, 2017, https://ftalphaville-cdn.ft.com/wp-content/uploads/2017/02/02104940/McHenry-letter-to-Yellen.pdf (accessed February 24, 2017).

12. "Presidential Executive Order on Core Principles for Regulating the United States Financial System," White House Press Office, February 3, 2017, https://www.whitehouse.gov/the-press-office/2017/02/03/presidential-executive-order-core-principles-regulating-united-states (accessed on February 22, 2017).

if the United States were to withdraw from international discussions of standards for the global financial system.

For one, the negotiations on Basel III have not been completed, and the new US administration would not be alone in its skepticism. Andreas Dombret, the representative of the Deutsche Bundesbank on the Basel Committee, said on February 2, 2017:

> [I]n the Basel III finalisation process, the Bundesbank has come out strongly against a further increase in capital requirements. Our motto must therefore be that no agreement in Basel is better than a bad agreement. At the same time, though, an international standard has a very high value that must not be underestimated. This is all the more true in a time in which more and more countries are turning inwards. The Bundesbank will also continue to work towards a compromise on Basel III—one that benefits Germany.[13]

Dombret appears to want to have it both ways: Finish Basel III but only on German terms. The Trump administration's view on the final chapter of Basel III is unknown, but it is reasonable to think that they will not compromise to the disadvantage of US banks relative to European banks, which appears to be the German position. On the other hand, John Dizard wrote in the *Financial Times* "the Washington lobbyists for US banks say US participation in discussions for the Basel III international regulatory framework for banks has effectively come to a halt.... The new administration is unlikely to be interested in any more global regulations."[14] Of course Dizard and the Washington lobbyists may not be right, but agreement to disagree on Basel III would in effect produce two standards with the attendant risk of regulatory arbitrage. Regulatory arbitrage via the adoption of the Basel II capital regime in Europe but not in the United States is viewed as one of the flaws in the system that contributed to the global financial crisis.

The ongoing FSB processes involve more than Basel III. US financial deregulation could lead to a number of outcomes: 1) the Volcker Rule limiting proprietary trading by US banks might be abandoned, creating de facto conflicts with other jurisdictions that have adopted similar efforts to ring-fence bank depositors; 2) the United States might no longer identify some or all US financial institutions as systemically important, putting the United States in conflict with such identifications by the FSB and other national jurisdictions; 3) deregulation could substantially alter the orderly liquidation authority provisions of the Dodd-Frank Act, undercutting global efforts to establish a common global framework for the resolution of banks with a global presence that are insolvent or close to being so; and 4) deregulation could force the Federal Reserve to abandon its CCAR processes, and pressures abroad to abandon or scale back stress tests would increase.

The possibility of reduced capital requirements poses a more immediate threat to the post-crisis regime for internationally active financial institutions. In his letter to Yellen quoted above, McHenry directly tied international agreements on higher capital standards implemented through the Federal Reserve to slower economic growth in the United States because of an adverse effect on bank lending. Similar views have been attributed to Gary Cohn, director of President Trump's National Economic Council.[15] These views persist despite substantial empirical evidence to the contrary (Gambacorta and Shin 2016; Goldstein 2017). If these views prevail in the United States and lead to a significant scaling back of capital requirements for US banks, one can expect a race to the bottom on global capital standards.

The international financial regulatory regime has been substantially strengthened in the 10 years since the global financial crisis; a breakdown of negotiations over Basel III and a halt to cooperation would be a severe blow to progress made on crisis prevention. If the United States were to withdraw from activities centered in the FSB and its associated standard-setting bodies, the United States would lose its influence over those activities potentially to the detriment of the US financial system. If the United States were to scale back its participation in FSB and related activities, the post-crisis regime would be incomplete, fragmenting the supervision and regulation of internationally active financial institutions and the global financial system. Mario Draghi, president of the European Central Bank and former chair of the FSB, told the European Parliament on February 6, "The last thing we need at this point is a relaxation in regulation. Frankly I don't see any reason to relax the present regulatory stance which has produced a stronger banking and financial services industry than before the crisis."[16]

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13. Andreas Dombret, "One size fits all? Applying Basel III to small banks and savings banks in Germany," speech at the *Handelsblatt* conference on "Future strategies for savings banks and Landesbanken," Berlin, February 2, 2017, http://www.bis.org/review/r170210a.pdf (accessed on February 22, 2017).

14. John Dizard, "Trump transition moves from detente to trench war," *Financial Times,* February 17, 2017, https://www.ft.com/content/5787e5ac-f466-11e6-95ee-f14e55513608 (accessed on February 22, 2017).

15. Binyamin Appelbaum, "Senate Panel Presses Yellen on Financial Regulation," *New York Times,* February 14, 2017, https://www.nytimes.com/2017/02/14/business/economy/federal-reserve-janet-yellen-congress.html?_r=1 (accessed on February 22, 2017).

16. Jeff Black and Jonathan Stearns, "Draghi Rebuts Trump Lines on Currency Wars, Bank Rules," Bloomberg,

The first-best option for the responsible authorities in other countries is to impress upon the Trump administration the importance of continuing the process of global financial reform. The report of Secretary Mnuchin's meeting with Bank of England Governor and FSB Chair Mark Carney is encouraging in its recognition of the benefits of international cooperation to the United States: "The Secretary stressed the importance of cooperation between the United States and other G-20 and Financial Stability Board members to achieve our common goals of addressing financial stability risks, fostering efficient global financial markets, and promoting a global level playing field." But the report also referenced "one of the Administration's core principles for financial regulation is to promote American interests in international financial regulatory negotiations and meetings."[17] Time will tell how this balance is struck.

Foreign leaders should try to convince the new US administration that international cooperation necessitates a certain amount of give-and-take and not to abandon institutions and agreements that support crisis prevention and global financial stability.

Meanwhile, foreign leaders should try to convince the new US administration that international cooperation necessitates a certain amount of give-and-take and not to abandon institutions and agreements that support crisis prevention and global financial stability. If they fail, other countries should carry on without the United States and resist a race to the bottom. However, they can be expected to protect their financial systems against US financial institutions that they feel are underregulated and undersupervised. The United States has an established precedent for keeping such institutions from doing business in the United States; in the future, the shoe may be on the other foot. Either way, the mechanisms of crisis prevention in support of global financial stability could well be weakened and damage the US financial system and economy.

CRISIS MANAGEMENT

After each financial crisis, crisis prevention takes center stage. Generally, but not always, some of the tools of crisis management are scaled back to limit moral hazard or because of controversies surrounding the use of those tools during the preceding crisis. Some argue that with better crisis prevention, some crisis management tools are no longer necessary. The same pattern has been observed in financial crises that affect more than one country, such as the global debt crises of the 1980s, the Tequila and Asian crises of the 1990s, and most recently the global financial crisis.

Timothy Geithner (2016, 2017) describes this phenomenon from the perspective of the US response to the latest crisis. He argues that while tighter regulations help clear away the "dry tinder" of excessive risk-taking, the scope for fiscal and monetary policy to deal with crises using conventional tools is now more limited than in 2007. He also argues that the US government has less emergency authority to deal with financial crises.

The tools of crisis management at the global level are often referred to as the global financial safety net. The global financial safety net was initially strengthened during and after the global financial crisis. Central bank swap lines were reestablished; some were made permanent. The IMF updated its financing tools by introducing its flexible credit line, which is designed for countries judged to have good policies but that may get sideswiped by a global financial crisis. It also introduced a precautionary liquidity line for countries judged to have somewhat weaker policies.[18] The resources of regional financial arrangements such as the Chiang Mai Initiative were expanded to form the Chiang Mai Initiative Multilateralization and its surveillance mechanism was upgraded. After a few ad hoc efforts, the euro area established the European Stability Mechanism as a permanent regional financial support institution.

Beatrice Weder di Mauro and Jeromin Zettelmeyer (2017) argue that the global financial safety net is incomplete.[19] They propose expanding the existing, unlimited bilateral swap arrangements among the central banks issuing reserve currencies[20] to include other countries, such as large

February 6, 2017, https://www.bloomberg.com/news/articles/2017-02-06/draghi-says-qe-strikes-balance-between-upturn-and-weak-inflation (accessed on February 22, 2017).

17. US Department of the Treasury, "Readout from a Treasury Spokesperson of Secretary Mnuchin's Meeting with Mark Carney, Governor of the Bank of England (BOE) and Chair of the Financial Stability Board (FSB)," press release, February 23, 2017, https://www.treasury.gov/press-center/press-releases/Pages/sm0013.aspx (accessed on March 3, 2017).

18. In the post-crisis period, the IMF also introduced its rapid credit facility and rapid financing instrument, which countries with urgent financial needs can use to borrow small amounts relative to their IMF quotas without full-blown policy programs.

19. The IMF (2016a) reached a similar conclusion.

20. In the post-crisis period, the central banks of Canada, the euro area, Japan, Switzerland, the United Kingdom, and the United States established swap lines of unlimited size, but

Box 2 Background on IMF Reform

The G-20 in 2009 endorsed a near $500 billion increase in the IMF's New Arrangements to Borrow (NAB).[1] The IMF prefinanced part of this increase by borrowing bilaterally before the expanded NAB became effective in 2011.[2] In 2010 in Seoul, Korea, the G-20 agreed to cut the size of the NAB roughly in half and roughly double IMF quota subscriptions. In the process, the quota and voting shares of some faster growing members, in particular emerging-market and developing countries, were increased. This was an important reform of IMF governance. However, the effective increase in IMF financial resources was less than 10 percent. In this connection, the Seoul agreement also accelerated the next (15th) review of IMF quotas from January 2016 to January 2014, with the presumption that total quotas would be significantly expanded and quota and voting shares would be further redistributed toward emerging-market and developing countries and principally away from Europe (Truman 2013a and 2014a).

1. At the same time the G-20 endorsed a $250 billion allocation of special drawing rights, which gave members increased access to unconditional international credit.

2. The NAB has 38 participating members out of the 189 members of the IMF.

emerging-market economies, by tying their qualification to participate to having IMF backing via a flexible credit line. This is an excellent, forward-leaning proposal, drawing in part on suggestions that I have made (Truman 2010, 2011, and 2013b). It would be in the US interest, as well as in the interest of the other countries whose central banks now participate in the unlimited swap network, to pursue the Weder di Mauro–Zettelmeyer proposal.

The Trump administration, however, might not support this proposal. Indeed, it could request that the Federal Reserve disengage from its current swap arrangements, which would undermine one of the crisis management tools put in place during the global financial crisis. Although the Federal Reserve enters swap arrangements under its own legal authority, it would be difficult for the Fed to continue those arrangements over the opposition of any administration. However, the Weder di Mauro–Zettelmeyer proposal, in principle, could be pursued without US participation.

The IMF, the institution traditionally at the center of managing international financial crises, already has been weakened relative to the plans laid down in the wake of the crisis. Initial agreements to enhance IMF resources were successfully implemented, but subsequent initiatives were delayed and finally ground to a halt; see box 2. The United States was the principal author of the Seoul agreements on IMF governance reform in 2010, but the US Congress and the Obama administration were unable to pass the legislation necessary to implement the package until December 2015. The consequences of this delay for crisis management were several.

the central bank wanting to draw has to receive the permission of the central bank making its currency available.

Consequences for IMF Resources and Governance Reform

G-20 leaders approved accelerating a further review of IMF quota subscriptions as part of the 2010 Seoul agreement; that review was derailed and is now expected to be completed by the fall of 2019. It is reasonable to assume that the Trump administration will not be eager to agree to a further increase in the US quota in the IMF, which would require not only endorsing the institution but asking the Congress for an appropriation. The United States can block any agreement on an increase in IMF quotas because it has a 16.5 percent share of votes in the IMF, and an 85 percent majority vote of the governors in the IMF is necessary to pass any resolution proposing an increase in quotas.

If the United States wants to support an increase in quotas and preserve its veto over certain decisions in the Fund, it would have to agree to an increase in its quota. Without an increase in the US quota, any increase in total IMF quotas of more than 9 percent would push the US voting share under 15 percent. In other words, if total IMF quotas are to increase substantially—enough to significantly and permanently increase IMF resources and further redistribute voting power toward the dynamic emerging-market and developing countries—US cooperation in some form is necessary. See box 3 on the status of IMF financial resources.

The Trump administration conceivably could agree to substantially increase total quotas without increasing the US quota, allowing the US voting share to decline below 15 percent, or it could agree to a significant increase in the US quota. If the administration chooses the second approach, would it tie implementation of the agreement to congressional approval, as was the case with the 2010 agreement? My view (see Truman 2014b) is that if a US administration decides it does not want to increase US financial support for the IMF, it should give up protecting its veto in the IMF.

Box 3 Background on IMF financial resources

The IMF's total financial resources are summarized in table 1. The totals include amounts currently on loan or committed by the IMF, which is about 27 percent of the estimated total of usable resources not deducting a prudential balance.[1]

Table 1 IMF financial resources (as of December 31, 2016, billions of US dollars)

Source	Amount	Estimated usable amount[a]
Quotas	651	546
New Arrangements to Borrow	247	222
Bilateral borrowing: total	357	321
2012 arrangements	164	148
2016 arrangements	193	174
Total	**1,255**	**1,089**

a. The estimate for quota subscriptions is 84 percent based on the share of quotas of countries whose currencies were included in the IMF's quarterly report *Financing IMF Transactions* of July 2016, http://www.imf.org/external/np/tre/ftp/2016/110116.htm (accessed on February 28, 2017). The estimate for borrowings is 90 percent to allow for the fact that the financial position of some countries making commitments will not permit them to lend to the Fund when asked. Because of this possibility, I have applied an adjustment factor of less than 100 percent. But the countries participating in these arrangements are generally in sounder financial condition that the general membership of the IMF, so the factor is larger than 84 percent.

Notes: The amounts are those potentially available to make loans out of the General Resources Account of the IMF. They include amounts on loan or committed as of February 2, 2017, which was $295 billion. Special drawing right (SDR) amounts are converted at 1 SDR = $1.3648262 and euro amounts, the currency of denomination in some loan commitments, are converted at 1 euro = $1.08 (rates as of February 2, 2017).

Source: International Monetary Fund.

About 30 percent of the IMF's resources come from bilateral borrowing arrangements; these are a third source of financial resources after quotas and the NAB. As of the end of 2016, these bilateral lines totaled $357 billion from 34 member countries. The IMF announced on October 7 that 25 members had committed a total of $340 billion in bilateral borrowed resources under a new 2016 program of bilateral arrangements replacing 2012 arrangements;[2] these are funds the IMF can potentially borrow to prefinance an expected increase in IMF quotas.

IMF doctrine is that "quota subscriptions are and should remain the basic source of the Fund's financing" (IMF 2016b). If the present proportion between quota subscriptions and potential NAB borrowing are maintained after the 2019 quota review—about 70 percent from quotas and the rest from an expansion of the NAB—that would imply about a 40 percent increase in quotas. This estimation does not take into account any future expansion in potential IMF financing needs. If the major central banks were to embrace the Weder di Mauro–Zettelmeyer proposal outlined above, and if, as expected, that led more IMF members to seek and successfully qualify for a flexible credit line, the IMF would need a substantial increase in its available financial resources to make credible the potential claims on the Fund.[3]

1. The prudential balance is the "amount set aside to safeguard the liquidity of members' claims and take account of the potential erosion of the IMF's resource base," http://www.imf.org/external/np/tre/activity/2017/020217.pdf (accessed on February 23, 2017). As of February 2, 2017, the prudential balance was $109 billion.

2. The press release states that the resources will be available through the end of 2020, but information on actual arrangements states that their expiration date is December 31, 2019. International Monetary Fund, "IMF Members Commit US$340 billion in Bilateral Borrowing to Maintain the IMF's Lending Capacity," press release, October 7, 2016, http://www.imf.org/en/News/Articles/2016/10/06/AM16-PR16447-IMF-Members-Commit-US-340-billion-in-Bilateral-Borrowing (accessed on February 23, 2017).

3. At present, almost 70 percent of the actual and potential use of IMF financial resources is accounted for by the three countries with flexible credit lines (Colombia, Mexico, and Poland).

The Trump administration should either adopt the first posture or the second without a link to congressional approval.[21] Other major countries should encourage the United States to do so.

If the United States, under any administration, does not value the contribution of the IMF to global and, therefore, to US economic growth and financial stability, it at least should get out of the way and not block IMF quota reform efforts. If the United States is uncooperative, other IMF members could establish a set of financing arrangements that do not include the United States—a SupraFund separate from but linked to the IMF with almost all the same features in terms of articles of agreement and procedures (see Truman 2014b and 2017 for details). The IMF's supplementary borrowing arrangements in which the United States is not a participant are a move in this direction.

Consequences for the New Arrangements to Borrow

When the Congress passed legislation at the end of 2015 approving the 2010 Seoul agreement, it included a provision that US participation in the 2022 renewal of the New Arrangements to Borrow (NAB) be subject to congressional approval.[22] The executive board would need to decide by November 2021 on a renewal starting one year later. Judging by past efforts to persuade the US Congress to pass legislation in support of the IMF, particularly when involving large sums of money de novo, congressional approval of US participation in the NAB would be a heavy lift for any administration. A second Trump administration or a new president's administration would have to deal with the IMF timetable set prior to the 2020 election. The US position in its decision on the review of IMF quotas discussed previously would be a major signal.

The US commitment to the IMF via the NAB is $38.5 billion or 15.6 percent of the total. This share allows the United States to block decisions to activate the NAB. But more importantly, if the United States were to pull out of the NAB, which provides 28 percent of the de facto permanent financial commitments to the Fund, it would be a severe blow to the institution, international monetary cooperation, and the ability of countries to manage crises that threaten global and US financial stability.

Would US withdrawal from the NAB participation kill the IMF? Assuming that a US withdrawal would be associated with a block on any increase in IMF quota resources, the Fund could continue to limp along and seek to augment its resources through bilateral borrowing. But governance reforms would be blocked as well. Countries would increasingly have to turn to other mutual support mechanisms, such as regional arrangements. Unless the US decision were reversed, the IMF as the central institution of crisis management would go into decline. A permanent US policy to scale back its financial participation in the IMF would be tantamount to withdrawal from the IMF, which the Trump administration could do (box 4).

Box 4 Thinking the unthinkable: US withdrawal from the IMF

The Trump administration could decide to withdraw immediately from the IMF. The Articles of Agreement of the IMF provide for a member to "withdraw from the Fund at any time by transmitting a notice in writing to the Fund at its principal office. Withdrawal shall become effective on the date such a notice is received" (Article XXVI). US accounts with the IMF would have to be settled and repayments at least started within six months. The United States would be due about $17 billion in foreign currencies equal to its reserve position in the IMF.

Consequences for IMF Lending

In its 2015 US legislation approving the IMF reform package, the Congress also imposed an unprecedented requirement that the IMF revise its policy on exceptional access, or lending for large financing programs. That policy had been changed in 2010 to permit the IMF to lend exceptional amounts in cases where there was not a high probability that the country's debt would become sustainable if there were also a threat to systemic stability. The IMF applied the exceptional access policy in programs for Greece, Ireland, and Portugal—successfully for the latter two countries but not for Greece. The Congress effectively used extortion to require the US administration—and via the administration other members of the IMF—to change this IMF policy if they wanted the 2010 Seoul reform package to go into effect. In this case, a majority of the other members favored this change; it had been principally the Obama administration that had been

21. Note that under the second approach, the United States would not necessarily lose its veto. It would only do so if the Congress did not agree with the administration. Although I favor the United States giving up its veto if the United States uses it to block progress on IMF resources and governance reform, I otherwise do not favor it until the combined voting share of the members of the European Union is reduced to that of the United States.

22. The legislation allowed the US secretary of the treasury to approve the renewal of US participation in the NAB in 2016. The IMF executive board did so for five years at the end of November 2016, effective at the end of November 2017.

among the countries preventing a compromise. As I wrote then,[23] this was, nevertheless, a horrible precedent.[24]

This provision was part of the price that Republicans in the Congress extracted from the Obama administration for passage of the IMF legislation. It suggests that the Trump administration may be reluctant to support any such large lending programs, for example for Brazil, Korea, Mexico, Turkey, and Ukraine. In the past, the United States has strongly supported most of these so-called bailout programs, finding the stability of the countries involved in the interest of the United States. Conservative governments in other member countries, such as Germany and the United Kingdom, tend not to favor such programs except when the potential recipients are in their own backyards.

Going forward, we may see fewer such large programs. This will have consequences for crisis management. Large-scale financial assistance will instead have to come from regional financial arrangements such as the European Stability Mechanism and the Chiang Mai Initiative Multilateralization. The problems with this devolutionary approach are two. First, as described by Weder di Mauro and Zettelmeyer (2017), the regional financial arrangements are unequipped financially or in their governance mechanisms to step into a hole left by the IMF, and they would be more exposed financially because of the preferred creditor status enjoyed by the Fund itself. Second, large portions of the world do not have any or large enough regional financial arrangements. Africa has none, and the Latin American Reserve Fund covers only a few countries and has less than $10 billion in lending capacity. Reliance on regional resources would likely lead to more forced sovereign and nonsovereign international defaults. Those concerned about moral hazard will cheer. Those concerned with contagion and global financial stability will be dismayed.

In addition to the IMF, the United States participates in and supports several related institutions. The Trump administration will have an immediate opportunity to show its intentions concerning other international institutions, such as the World Bank; see box 5.

Over the past seven decades, US administrations have found the institutions of international economic and financial cooperation useful in advancing US interests. The United States has turned to the IMF in particular to help support countries as diverse as the United Kingdom and Pakistan. When a financial crisis breaks out despite efforts at crisis prevention, the United States has tapped the resources of the IMF, including to help protect financial stability at home. IMF support for Mexico in 1995 protected the US economy and financial system from an even deeper hit at that time. The IMF's role in responding to the global financial crisis was critical to avoiding a repeat of the Great Depression. Those resources are a large, prepositioned commitment of funds not only from US taxpayers but from taxpayers in other member countries. Consequently, not only does the US administration not have to go to the US Congress to obtain financial resources every time crisis strikes a country of US interest—be it Egypt, Mexico, Korea, Ukraine, or South Africa—but also the administration can leverage the prior financial commitments of other members. Perhaps more important, the United States can use the financial leverage and other activities of the IMF to influence economic and financial policies in other countries, which further strengthens crisis prevention. The IMF has had its successes and failures in its programs, but most observers looking back over the decades would say the former on balance outnumber the latter.

If the Trump administration does not fully recognize the benefits of international cooperation to crisis management, the United States and the world will be worse off. One can hope that policymakers in other countries will proactively try to persuade the Trump administration not to turn inward. If they fail, I have outlined some of the second- and third-best approaches to consider (Truman 2014b and 2017).

CONCLUSION

The Trump administration may in time fully recognize the contribution that international cooperation makes to the economic and financial health and security of the United States, but that is far from certain. The administration's possible alternative approaches to such international cooperation range from discouraging to frightening. Observers should be discouraged if the new administration pulls back from proactive involvement with the international institutions that cooperate on crisis prevention and crisis management. Observers should be frightened if the United States pulls out of these organizations entirely.

On crisis prevention, reforming and replacing the Dodd-Frank Act is likely to weaken the US financial system—the linchpin of the global financial system—which could well place it in conflict with some international standards agreed on after the global financial crisis of 2007–09 or still under discussion. If the United States discontinues playing a

23. Edwin M. Truman, "IMF Governance Reform: Better Late than Never," RealTime Economic Issues Watch, Peterson Institute for International Economics, December 16, 2015, https://piie.com/blogs/realtime-economic-issues-watch/imf-governance-reform-better-late-never (accessed on February 2, 2017).

24. The 2015 legislation also requires any future administration to report to the Congress before supporting any future IMF programs involving exceptional access to IMF resources. This provision does not cripple the IMF from approving such programs because they require only a majority vote in the executive board.

Box 5 US support for other international organizations

President Obama's proposed FY 2017 budget requested about $25 billion for all development and humanitarian assistance including participation in international organizations, most of which, unlike the IMF, receive payments from the United States every year. In the case of the World Bank, its members agreed in the fall of 2015 on a roadmap to review the resources and governance of the World Bank Group (the International Bank for Reconstruction and Development). Part of the roadmap consisted of the 18th replenishment of the International Development Association (IDA); in December 2016 the United States committed to providing the same dollar amount to IDA, $3.9 billion over three years, as it had committed to the previous replenishment. The World Bank executive board has also agreed to a revised formula to set general and selective capital increases for the World Bank itself and the International Finance Corporation by the fall of this year. Thus, the Trump administration will have to decide its policy toward one of the Bretton Woods institutions in the next several months.

In the FY 2017 budget, the Obama administration asked for about $3 billion to support international financial institutions, such as the multilateral development banks, and programs associated with food security and the environment, including $1.4 billion for IDA. The Congress typically appropriates about 80 percent of the administration's request. The result is that the United States had about $1.5 billion in unmet commitments at the start of the fiscal year, including $530 million for IDA. The Trump administration soon will submit a budget for FY 2018 and its plans for the remainder of FY 2017. If total outlays for all international programs housed in the State Department and Treasury were subject to the 30 percent cut across the board that White House sources have discussed with the press, this would mean a cut of about $7.5 billion for all development and humanitarian assistance and about $900 million for financial institutions and programs. These cuts would not immediately cripple these institutions, but they would have consequences that would cumulate over the four years of the Trump administration including for US leadership and influence in the institutions. Moreover, as more than 120 former high-level military officials, concerned with press reports of budget cuts in this area, wrote to Congressional leaders, "elevating and strengthening diplomacy and development alongside defense are critical to keeping America safe."[1] Political stability is linked to financial stability.

1. Sidney Traynham, "Over 120 Retired Generals, Admirals on State and USAID Budget: 'Now is not the time to retreat'," February 27, 2017, U.S. Global Leadership Coalition, http://www.usglc.org/2017/02/27/over-120-retired-generals-admirals-on-state-and-usaid-budget-now-is-not-the-time-to-retreat/ (accessed on March 2, 2017).

positive role in international standard-setting bodies and the FSB, international financial reform will grind to a halt. At worst, there would be a race to the bottom; at best, other countries would struggle on with a more fragmented system fraught with regulatory arbitrage and hope that the United States comes to its senses.

On crisis management, if future US support for the institutions of international monetary cooperation, the IMF in particular, is minimal at best and negative at worst, the inevitable financial crises will be more challenging to handle. Other countries either will have to strengthen those institutions without the United States or strengthen regional institutions in which the United States is not a member.

The leaders and senior policymakers of other countries should recognize the risks posed to global financial stability in both crisis prevention and crisis management by some indications of the Trump administration's policy inclinations; such recognition seems to be happening to some degree. They should also seek to convince the administration that international financial cooperation is in the interests of the United States, which we can hope is happening. But they also need to be prepared to go it alone largely without traditional US support if their efforts at persuasion fail.

This on-the-whole negative prospect for international cooperation could change. In the early months of the Trump administration, a financial crisis may affect a country that the US government wants to help. This was the case for the administration of George W. Bush whose leadership team was also skeptical of large IMF programs. In its first months, Turkey faced a renewed crisis, and the United States called on the IMF to restart its program with Turkey on a larger scale. The same happened subsequently in Brazil and several other countries. At the end of the Bush administration, which tended to favor domestic financial deregulation, the United States promoted the G-20 to the level of presidents and prime ministers and supported the process that led to substantial if still incomplete reforms in international financial regulation. One should not hope for disaster, but sometimes disasters are necessary to change policies and attitudes.

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