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The IMF's Proposed New Arrangements to Borrow (NAB): An Overview

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ABSTRACT

In the wake of the 1994-1995 Mexican financial crisis, the major industrial countries proposed the "New Arrangements to Borrow" (NAB). The NAB are an arrangement of medium-term credit lines that would provide additional funds to the International Monetary Fund (IMF) in the event of an international financial crisis. The U.S. share of $3.4 billion is under consideration by the 105th Congress. This report will be updated as necessary. For legislative issues related to the NAB, see CRS Issue Brief 97038, *The International Monetary Fund's Proposed Quota Increase and "New Arrangements to Borrow: (NAB)*, by (name redacted). Updated regularly.

The IMF's Proposed New Arrangements to Borrow (NAB): An Overview

Summary

In the wake of the Mexican financial crisis, the major industrial countries agreed, at the Halifax economic summit of June 15-16, 1995, to establish an "emergency financing mechanism." This goal would be achieved by the proposed establishment of the "New Arrangements to Borrow" (NAB), adopted by the International Monetary Fund's (IMF) Executive Board on January 27, 1997. The proposed NAB are medium-term lines of credit that will provide funds to the IMF to enable it to "forestall or cope with an impairment of the international monetary system, or to deal with an exceptional situation that poses a threat to the stability of the system."

Commitments totaling SDR 34 billion, currently about $45.1 billion, have been received from 25 countries. The total U.S. commitment to the NAB is SDR 6,712 million. SDR 2,462 million of the proposed U.S. share in the NAB — the increment above an existing U.S. participation of SDR 4,250 in an earlier credit arrangement, the "General Arrangements to Borrow" (GAB) — will require authorization and appropriation by the U.S. congress. This amount is scored in the FY 1999 budget as $3.4 billion. Under current budgetary and accounting practices, however, U.S. participation in the NAB is considered to be an exchange of assets and, therefore, to have no impact on the U.S. federal fiscal position.

The NAB are easier to activate than the predecessor GAB. This results from dropping the GAB requirement that, when making a call for funds on behalf of nonparticipants, the IMF face an "inadequacy" of resources. It is this shift that effectively establishes the NAB as the facility of first recourse.

The NAB are currently under consideration by the 105th Congress. Under prevailing budgetary and accounting practices, the NAB are subject to the requirement of both an authorization and appropriation. The occasion of a request for IMF funding also presents an opportunity for vigorous congressional oversight of the IMF's programs and operations.

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The Mexican peso devaluation of December 20-22, 1994 stunned the international financial world. Ultimately, it led to a commitment by the United States to provide an unprecedented $20 billion financial support package to Mexico. It also raised a variety of concerns regarding the functioning of the international monetary system itself. Chief among these concerns is the ability of current international financial institutions, most notably the International Monetary Fund (IMF), to cope with financial crises generated by the sudden movement of short-term capital or portfolio investment, sometimes referred to as "speculative" flows or "hot money."

In March 1995, the IMF began a review of the adequacy of the "General Arrangements to Borrow" (GAB)[1] to deal with the potentially disruptive impact of short-term capital flows. The GAB are an arrangement of emergency medium-term credit lines established in 1962 and expanded in 1983. They provide supplementary resources to the IMF in order to enable it to forestall or cope with an impairment of or threats to the international financial system. In light of this review, the leaders of the G-7 countries, at the Halifax economic summit on June 15-16, 1995, proposed to create a similar "emergency financing mechanism" supported by a suggested doubling of the GAB. This proposed new financing mechanism, now called the "New Arrangements to Borrow" (NAB), was adopted by the IMF's Executive Board on January 27, 1997. Like the GAB, the proposed NAB are an arrangement of medium-term credit lines that the IMF may borrow against in the event of an international financial crisis.

Commitments to the NAB totaling SDR 34 billion[2] have been received from 25 countries. SDR 2,462 million of the U.S. share of the NAB — the increment above the existing SDR 4,250 million U.S. participation in the GAB — will require authorization and appropriation by the U.S. Congress. The SDR 2,462 million incremental contribution is scored in the FY 1999 budget as $3.4 billion.

The NAB are currently under consideration by the 105th Congress. Under prevailing budgetary and accounting practices, the NAB are subject to the requirement of both an authorization and appropriation. The occasion of a request

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[1] Additional information on the GAB is provided in CRS Report 97-467 E, *The IMF's "General Arrangements to Borrow" (GAB): A Background Paper*, by (name redacted). 5 p.

[2] The "Special Drawing Right" or SDR is an international reserve asset created by the IMF. All IMF accounts are denominated in SDRs, whose value, in terms of the U.S. dollar, fluctuate on a daily basis. For example, the SDR was equal to $1.32523 on August 24, 1998.

for IMF funding also presents an opportunity for vigorous congressional oversight of the IMF's programs and operations.[3]

This report analyzes the proposed "New Arrangements to Borrow." This report will be updated as necessary.

The New Arrangements to Borrow (NAB): The Facility of First Recourse

The NAB are parallel and complementary to its predecessor, the GAB, which remain in force. They are also supplemental to the GAB. Existing financial commitments to the GAB are counted as part of the total SDR 34 billion in financial commitments that comprise the NAB. Thus, in this sense, the GAB are subsumed within the NAB. Significantly, the NAB will be the facility of first and principal recourse. The similarities between the NAB and the GAB are striking, as can be seen from **Table 1** on the next page.

[3]For legislative issues related to the NAB, see CRS Issue Brief 97038, *The International Monetary Fund's Proposed Quota Increase and "New Arrangements to Borrow" (NAB)*, by (name redacted). Updated regularly.

Table 1. Comparison of the Proposed "New Arrangements to Borrow" (NAB) and the "General Arrangements to Borrow" (GAB), Selected Characteristics

Characteristic	NAB	GAB
Number of Participants	25	11[1]
Total Value of Commitments	SDR 34 billion	SDR 17 billion
Permits New Adherents	Yes	Yes
Interest Rate	SDR Rate	SDR Rate
Maximum Repayment Period	5 years	5 years
Duration	5 years	5 years
Expiration Date	5 years after entry into force	37979
Criterion for Use by Participants	"Impairment" of System	"Impairment" of System
Number of Votes Needed to Activate	In practice, unanimous; fall-back procedure: 2/3 of voting participants + 3/5 majority weighted according to the amount of their credit lines	80% majority of participants
Able to be Used for Nonparticipants	Yes	Yes
Criteria for Use for Nonparticipants:		
"Threat" to System	Yes	Yes
IMF Program Required	Yes	Yes
"Inadequacy" of IMF Resources	No	Yes

Source: CRS.

[1] Saudi Arabia, which is not a participant in the GAB, has an associated SDR 1.5 billion credit arrangement with the IMF.

The most important difference between the NAB and the GAB are the former's lack a requirement that the IMF demonstrate that its resources are "inadequate" when a potential draw would involve a non-participant — a significant barrier presented by the GAB. It is the omission of this requirement that turns the NAB into the facility of first resort. The "inadequacy" requirement might well have been among the reasons why the GAB were not activated during the 1994 Mexican crisis.[4] Perhaps more to the point, under U.S. law it would appear that the GAB requirement to demonstrate an inadequacy of resources could not be altered without congressional

[4] It is also probable that there would have been political resistance to activating the GAB for Mexico had it been proposed. Some major countries were, at least initially, opposed the IMF's 1995 loan to Mexico, which, up until then, was the largest loan the IMF had ever made. See CRS Report 95-428 E, *Mexico's 1995 Economic Program and the IMF*, by (name redacted), p. 4.

approval.[5] Under the current proposal, the GAB and the funds appropriated for U.S. participation in the GAB remain intact, while access requirements are eased.

The NAB remain in effect for five years from their entry into force. Renewal of the GAB does not require congressional approval; they have been extended until December 25, 2003.

Both the NAB and the GAB permit new adherents. This might suggest a "fall-back" position in the event that Congress does not approve U.S. participation in the NAB.

The NAB: Participants and Contributions

The NAB have broader participation than the GAB, reflecting changes in the global economy and an extension of burden-sharing beyond the major industrial nations. As shown in **Table 2** on the next page, there are twenty-five potential participants in the NAB. The bulk of the commitments to the NAB derive from GAB participants. Altogether the original participants of the GAB plus Saudi Arabia, which has an SDR 1.5 billion arrangement associated with the GAB, account for SDR 28,627 million or 84.2 percent of the NAB. This represents an increase of SDR 10,127 million 54.7 percent over their participation under the earlier credit arrangements.

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[5] 22 U.S. Code 286e-2(d) would appear to foreclose amending the GAB to drop this requirement without congressional approval. It states:

> Unless the Congress by law so authorizes, neither the President, the Secretary of the Treasury, nor any other person acting on behalf of the United States, may instruct the United States Executive Director to the Fund to consent to any amendment to the Decision of February 24, 1983, of the Executive Directors of the Fund, if the adoption of such amendment would significantly alter the amount, terms, or conditions of participation by the United States in the General Arrangements to Borrow.

The referenced IMF decision of February 24, 1983 is the current version of the GAB, as amended in 1983.

Table 2. New Arrangements to Borrow (NAB) Participants and Credit Arrangements (Million)

Country/ Central Bank	Contribution to NAB, Value (SDR[1])	Share of NAB (%)	Approximate US Dollar Equivalent[2] ($)	Share of GAB[3], Value (SDR[1])	Share of GAB[3] (%)	Increase from GAB,[3] (SDR[1])
United States	6,712	19.7	$8,894.9	4,250.0	25.00	2,462.0
Deutsche Bundesbank	3,557	10.5	$4,713.8	2,380.0	14.00	1,177.0
Japan	3,557	10.5	$4,713.8	2,125.0	12.50	1,432.0
France	2,577	7.6	$3,415.1	1,700.0	10.00	877.0
United Kingdom	2,577	7.6	$3,415.1	1,700.0	10.00	877.0
Saudi Arabia[4]	1,780	5.2	$2,358.9	—	—	280.0
Italy	1,772	5.2	$2,348.3	1,105.0	6.50	667.0
Swiss National Bank	1,557	4.6	$2,063.4	1,020.0	6.50	537.0
Canada	1,396	4.1	$1,850.0	892.5	5.25	503.5
Netherlands	1,316	3.9	$1,744.0	850.0	5.00	466.0
Belgium	967	2.8	$1,281.5	595.0	3.50	372.0
Sveriges Riksbank (Sweden)	859	2.5	$1,138.4	383.5	2.25	476.5
Australia	810	2.4	$1,073.4	—	—	—
Spain	672	2.0	$890.6	—	—	—
Austria	412	1.2	$546.0	—	—	—
Norway	383	1.1	$507.6	—	—	—
Denmark	371	1.1	$491.7	—	—	—
Kuwait	345	1.0	$457.2	—	—	—
Finland	340	1.0	$450.6	—	—	—
Hong Kong Monetary Authority	340	1.0	$450.6	—	—	—
Korea	340	1.0	$450.6	—	—	—
Luxembourg	340	1.0	$450.6	—	—	—
Malaysia	340	1.0	$450.6	—	—	—
Singapore	340	1.0	$450.6	—	—	—
Thailand	340	1.0	$450.6	—	—	—
TOTAL	**34,000**	**100%**	**$45,057.8**	**SDR 17,000.0**	**100%**	**SDR 10,127.0**

Source: CRS.

[1] SDR=Special Drawing Right.

[2] Calculated at the rate of $1.32523 per SDR, as of August 24, 1998.

[3] GAB=General Arrangements to Borrow.

[4] Saudi Arabia is not a participant in the GAB, but has an associated SDR 1.5 billion credit arrangement with the IMF.

The United States has a proposed SDR 6,712 million share of the NAB, which represents an SDR 2,462 million or 57.9 percent increase over its SDR 4,250 million participation in the GAB. The NAB, therefore, increases the total U.S. exposure to financial risk. The percentage share of U.S. participation in the NAB, however, is 19.7 percent, compared to its 25.0 percent participation in the GAB. Thus, the U.S. *share* of the exposure is reduced. In other words, burden-sharing is enhanced under the NAB.

In addition to the original eleven countries that participated in the GAB and Saudi Arabia, there are thirteen new countries participating in the NAB. Six of the new participants are in Europe: Spain, Austria, Norway, Denmark, Finland, and Luxembourg. Jointly, they are providing SDR 2,518 million. Six countries in Asia and the Pacific are providing a further SDR 2,510 million. Australia is providing nearly one-third of this, while Hong Kong, Korea, Malaysia, Singapore, and Thailand are each providing the minimum commitment of SDR 340 million. Hong Kong, whose participation is managed by the Hong Kong Monetary Authority (HKMA), is not an IMF member. For the purposes of the GAB, the HKMA is regarded as an official institution of the IMF member whose territories include Hong Kong, formerly Britain and now China. Finally, Kuwait is extending SDR 345 million.

Notably missing from the list of NAB participants are any major Latin American countries.

Entry Into Force

The NAB enter into force when adopted by participants with credit arrangements totaling SDR 28.9 billion, including the five participants with the largest credit arrangements. The latter include the United States, Germany, Japan, France, and the United Kingdom. Each of these five countries, notably the United States, can, therefore, prevent the NAB from entering into force. As of this time, all participants other than the United States and Germany have officially ratified their participation.

The NAB, like the GAB, will remain in force for five years. At that time the NAB may be renewed.

Activation of the NAB

The requirements for activating the NAB parallel those of the GAB on which it is modeled. Like the GAB, the NAB may be drawn on by both participants and non-participants. The NAB are intended to be used to "forestall or cope with an *impairment* of the international monetary system, or to deal with *an exceptional situation* that poses a *threat* to the stability of that system."[6] [Italics added.] The

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[6] IMF. Press Release No. 97/5, issued on January 27, 1997.

requirement of an "exceptional situation" that poses a "threat" is applied to a call for the benefit on nonparticipants.

Procedures for activating the NAB for non-participants are somewhat more flexible than those under the GAB.[7] The GAB requires an additional condition that the IMF's Managing Director must find, after consultation, that the IMF faces an inadequacy of resources. Both the GAB and the proposed NAB require non-participants to have IMF stabilization programs in place in order to draw on these credit lines.

Like any credit arrangement, the lenders will receive interest when the credit line is activated. Interest will be paid to the NAB creditors at the SDR interest rate, which fluctuates, reflecting the short-term market rates of the SDR's constituent currencies — the U.S. dollar, the German mark, the Japanese yen, the French franc, and the U.K. pound sterling.

New Members

A country or institution may become a participant in the NAB in one of two ways:

- when the NAB are up for renewal five years after entry into force, if the IMF and participants representing **80 percent** of the credit lines agree, or

- at any other time through an amendment to the NAB, if the IMF and participants representing **85 percent** of the credit lines agree.

Governance

The NAB are fully under the control of its participants. Participants will meet once a year at the time of the IMF's Annual Meeting, which occurs in September or October of each year. Chairmanship of the NAB grouping will rotate annually according to the English alphabetical order of the participants. Staff support will be provided by the IMF. Topics for discussion will include, in addition to matters pertaining to the NAB, macroeconomic and financial market developments.[8]

Not All There Is: Concurrent Funding Proposals

The NAB are one of a series funding proposals that are intended to underpin the IMF's future operations. These proposals include:

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[7] IMF. *Survey*, February 10, 1997, p. 33.

[8] IMF. Press Release No. 97/5, issued on January 27, 1997.

- participation in a proposed quota or capital increase, the U.S. share of which would amount to SDR 10,622.5 million (scored in the FY 1999 budget as $14.5 billion),

- a U.S. contribution of $7 million that is part of an outstanding commitment of $75 million to the Interest Subsidy Account of the Enhanced Structural Adjustment Facility (ESAF), and

- a proposed allocation of SDRs equal to SDR 21 billion.[9]

Quotas, or members' capital subscriptions, are the IMF's fundamental financial resource, its permanent source of financing.[10] Quotas are what enable the IMF to undertake its loan operations. Quotas also determine members' voting rights, borrowing rights, and share of any SDR allocation, if there is one. The quota increase, the largest portion of the proposed funding package.

The NAB are a supplemental, emergency mechanism. They would provide temporary financing for the IMF only when necessary. Thus, they are a non-quota based source of financing for the IMF. The NAB are not, therefore, intended to substitute for a quota or capital increase.

The Enhanced Structural Adjustment Facility (ESAF) was established in December 1987 and extended and enlarged in February 1994. ESAF provides assistance to low-income countries undertaking medium-term structural adjustment programs. The Interest Subsidy Account was established to finance the low rate of interest that the ESAF loans carry.

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[9]The current proposal, adopted in September 1997, calls for a new allocation of SDR 21.4 billion, thereby doubling the number of SDRs outstanding. The proposal to allocate SDRs, because it would require an amendment to the IMF's Articles of Agreement, would also require congressional authorization. Because no U.S. funds would be involved, however, no appropriation would be required. Although the proposed SDR allocation is part of the broader IMF funding picture, it has not yet been brought forward for congressional consideration. For more details, however, see CRS Report 97-738 E, *The IMF's Proposed Special Drawing Rights' (SDR) Allocation: A Background Paper*, by (name redacted). 17 p.

[10] For more details on the financial structure of the IMF, see CRS Report 97-228 E, *The International Monetary Fund: A Short Overview*, by (name redacted), 6 p., and CRS Report 98-412 E, *International Monetary Fund (IMF): Costs and Benefits of U.S. Participation*, by (name redacted), 21 p.

For specific information on the proposed quota increase see, CRS Report 98-56 E, *The International Monetary Fund's (IMF) Proposed Quota Increase: Issues for Congress*, by (name redacted), 15 p.

Major Policy Issues: Moral Hazard, Contagion, and Burden-Sharing

An expanded treatment of policy issues regarding U.S. participation in the IMF appears in CRS Report 98-56 E, *The International Monetary Fund's (IMF) Proposed Quota Increase: Issues for Congress*, and is equally applicable to the NAB. What follows here is a limited treatment of only three selected issues.

Perhaps the most serious economic argument against funding the IMF rests on the issue of "moral hazard," that is, that financing by the IMF, particularly emergency financing provided during financial crises ("bailouts"), encourages the very behavior that it seeks to prevent. According to this view, countries know that they will be spared the worst consequences of bad economic management. In the event, as the 1994-1995 Mexican crisis demonstrated and the Asian crisis is already demonstrating, countries are not spared the consequences of imprudent economic policies. The real economies of financially troubled countries and the people who live in them suffer the painful consequences of a forced economic adjustment. The policy question is whether the unavoidable economic pain is to be somewhat mitigated by external financial support tied, in turn, to a conditional economic adjustment program.

A different type of "moral hazard" also arises with regard to investors. Does the existence of an emergency financial mechanism encourage private investors to take on risks that they might otherwise shun in an attempt to reap greater financial returns? In this context, some are troubled that, as a by-product of a "bailout," professional investors, who took on higher risks and were most probably rewarded with higher returns, are made whole.

Investors whose activities require mark-to-market accounting treatment have sustained immediate financial losses on their holdings in Asia. This would include portfolio investment and trading activities, including foreign exchange. Financial activities where accounting rules do not require marking-to-market and, thus, immediate loss recognition — specifically, commercial bank lending, where loans are carried at par or face value — will, nevertheless, face economic losses as loans to Asia, Russia, and, perhaps, other troubled markets are increasingly rescheduled or written off. Moreover, some commercial banks will have already sustained losses in connection with trading activities.

According to Federal Reserve Board Chairman Alan Greenspan, testifying before the Senate Subcommittee on Foreign Operations on March 3, Asian equity losses (excluding Japanese companies), exceeded $700 billion from June 1997 to the end of January 1998. More than $30 billion of this loss was sustained by U.S. investors. Substantial further losses have been recorded in bonds and real estate.

The moral hazard issue is particularly troubling with regard to the expanded financial package provided to Russia in July 1998. Because of its nuclear capability and strategic importance, Russia appears to have been placed in the category of "too big to fail." Investors clamored for an IMF package while simultaneously investing in short-term government notes (GKOs) — in effect asking for a guarantee of their

capital. Further assistance was not provided in August, however, with a ruble devaluation resulting. The reported reason for a failure to provide additional assistance was an insufficiency of IMF resources .[11]

A crisis might well also have an impact that extends beyond the difficulties of a particular country — the "contagion" issue. This was a major concern of policymakers as the late 1994 Mexican crisis unfolded, proving then to be justified. This issue continues to be a major concern during the current financial crises in Asia and Russia.

Consideration of the NAB proposal (and the proposed quota increase) is now occurring against the backdrop of a international financial crisis that began with a currency crisis in Thailand, resulting in the devaluation of the Thai baht on July 2, 1997. The crisis spread first to the currencies of other Southeast Asian nations, then to Taiwan and Hong Kong. In October 1997, it reached all major financial markets, including those of the United States. In November, Korea, the world's eleventh largest economy, began to experience severe pressure, eventually leading it to the door of the IMF.[12] In May 1998, continuing volatility in emerging markets led to a financial crisis in Russia.[13] More recently, the Japanese yen and the South African rand have been under great pressure. The U.S. government intervened in support of the yen on June 17. Federal Reserve Chairman Greenspan's testimony of March 3, thus, continues to be relevant:

> [t]here is . . . a small but not negligible probability that the upset in East Asia could have unexpectedly large negative effects on Japan, Latin America, and eastern and central Europe that, in turn, could have repercussions elsewhere, including the United States. Thus, while the probability of such an outcome may be small, its consequences, in my judgment, should not be left solely to chance.

The trade-off, thus, is between systemic risk and the making whole of some investors as an unintended and undesirable consequence of providing emergency assistance to the troubled countries of Asia.

An incentive toward U.S. participation in the IMF, in general, and the NAB, in particular, is the potential spreading of risks and costs associated with future financial crises. As made clear by Treasury Secretary Robert E. Rubin, "[t]he United States cannot be the lender of last resort to the world."[14] This policy not only remains in place, but appears to be a guiding principle for U.S. policy in dealing with the crisis of 1997-1998.

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[11]Davis, Bob. IMF Lacked Cash to Stem Ruble's Latest Plunge, Casting Doubts on More Bailouts, Agency Tactics. *Wall Street Journal*, August 18, 1998, A12.

[12]For more details on the Asian crisis, see CRS Report 98-434 E. *The Asian Financial Crisis, the IMF, and Japan: Economic Issues*, by (name redacted), 30 p.

[13]For details of the Russian crisis, see CRS Report 98-578 E, *The Russian Financial Crisis: An Analysis of Trends, Causes, and Implications*, by (name redacted), 6 p.

[14]*The New York Times*, June 17, 1995, p. 34.

Some who oppose funding for the IMF reject the concept of such an international financial institution. Other critics who oppose the quota increase and the NAB may base their opposition on specific concerns about IMF policies. For these critics, the institution's performance during the Asian and Russian crises might well be considered a test of its competency to act effectively in future crises.

The Need for the IMF Funding: the Supply Side

The IMF's "liquidity ratio" has been used as a way of examining the adequacy of the IMF's financial resources. In the current debate over funding the IMF, however, the "liquidity ratio" itself has received some attention. This is largely attributable to the fact that the ratio is seen as having a built-in adjustment (reserve or cushion) for future contingencies that results in an understatement in the IMF's available financial resources.[15]

Alternate View I: The "Illiquidity Ratio"

Figure 1. Ratio of IMF Reserve Tranche Positions to Paid-in Capital (Illiquidity Ratio), End-of-Calendar Year 1950-May 1998

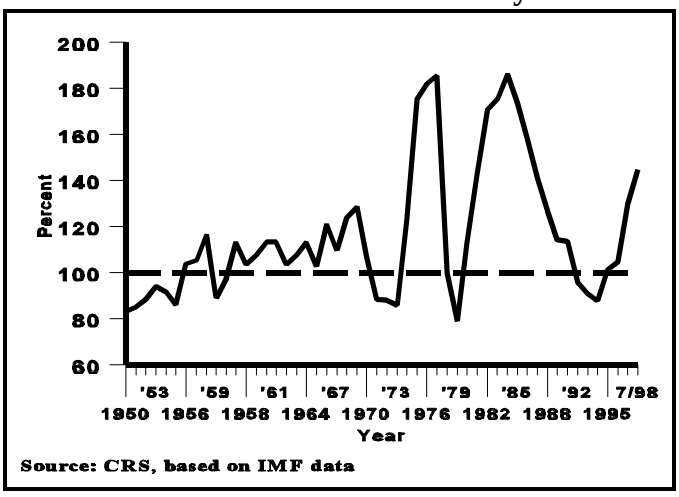

Figure 1 presents an alternative to the IMF's "liquidity ratio." The alternative ratio, which has been dubbed the "illiquidity ratio" in order to distinguish it from the IMF's ratio, presents the ratio of reserve tranche positions to paid-in capital. In figure 1, very simply, the higher the ratio moves above the 100% level, the more financially constrained the IMF is becoming (For a more complete description of the illiquidity ratio, see **Appendix I** at the end of this report. The illiquidity ratios themselves are presented in **Appendix I Table 1**. For a comparison of the illiquidity ratio to the IMF's liquidity ratio, see **Appendix II**.)

As of May 31, 1998, the latest published data, total reserve tranche positions for all IMF members were equal to 142.5% of paid-in capital — the highest ratio since 1986 (158.4%).

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[15]See General Accounting Office. *International Monetary Fund: Observations on Its Financial Condition*. Statement of Harold J. Johnson, Jr. before the Joint Economic Committee, July 23, 1998.

By the time of a press conference held on July 13, 1998 by IMF Treasurer David Williams, total reserve tranche positions had risen again to SDR 52.6 million. This results in an "illiquidity ratio" of 144.9%. This level was the ninth highest "illiquidity ratio" in the 48 full years since 1950. Three of the years that had higher ratios occurred during the peak of the petrodollar crisis of the 1970s. The remaining five occasions occurred during the 1980s' debt crisis, during which the IMF's financial condition was more illiquid than at any time during the 48 years that were considered here — the worst year being 1984, when the illiquidity ratio reached its highest level ever, 186.3%. By historic standards, the IMF's quota-based resources are, without question, under substantial pressure. This conclusion is reached without taking into account the Russian loan that was approved on July 20.

Alternate View II: The GAB and an Inadequacy of Resources

Yet another way to look at the IMF's need for funding is to examine the now ten occasions on which the "General Arrangements to Borrow" (GAB) have been activated. The GAB are only activated when the IMF needs additional resources to deal with an "impairment" of or a "threat" to the international monetary system. For that reason, the GAB have been rarely activated and only when the 11 major industrial countries that participate in the GAB (see **table 2** on page 5) determine that extreme circumstances require the additional resources. The most recent activation was on July 20, 1998, when the IMF made a call on the GAB in order to provide financial assistance to Russia.

Table 3 on the next page shows the illiquidity ratio at month-end just prior to each GAB activation or a "call," the size of the loan ("purchase") that triggered the call, and its hypothetical effect on the IMF's illiquidity ratio (here termed the "adjusted illiquidity ratio"), assuming that the full amount of the loan had been funded without activating the GAB. The hypothetical or "adjusted" illiquidity ratio obtained after allowing for the full amount of the Russia loan announced in July 1998 was the third highest of the ten calls, lower only than the 1977 activations for Britain and Italy. These latter two instances occurred during the international oil crisis of the 1970s. Thus, this comparison would also tend to support the conclusion that the IMF is, at present, seriously constrained financially.

Table 3. Illiquidity Ratio Prior to Activation of the "General Arrangements to Borrow" (GAB) and After Adjustment for the Amount of the Purchase

Month of Activation	Beneficiary	Illiquidity Ratio Month-end Prior to Activation	Amount of Purchase (Million $ or SDRs)	Adjusted Illiquidity Ratio
Dec. 1964	United Kingdom	98.6%	$1,000	123.8%
May 1965	United Kingdom	105.8%	$1,400	140.8%
Nov. 1967	United Kingdom	112.4%	$1,400	139.1%
June 1968	France	108.6%	$745	122.7%
June 1969	United Kingdom	110.5%	$500	119.9%
Sept. 1969	France	119.4%	$985[1]	138.0%
Jan. 1977	United Kingdom	242.8%	SDR 3,360[1]	288.9%
May 1977	France	253.8%	SDR 450[1]	260.0%
Nov. 1978	United States	72.6%	SDR 2,275	80.6%
July 13, 1998	Russia	144.9%	SDR 8,460	168.1%

Source: CRS, from IMF data.
[1] Proposed, but not fully drawn.

The Need for the IMF Funding: the Demand Side

The resource needs of financially troubled countries always exceed what the IMF is able or willing to provide. The IMF's role is to rebuild confidence, to be a "catalyst" to private funding. The current, perilously low level of IMF resources, therefore, raises concern given the continuation of volatility in a number of financial markets.

According to IMF Treasurer Williams, the IMF had "net usable resources" (IMF definition) of SDR 23.5 billion on July 13. Commitments to Russia under the Compensatory and Contingency Financing Facility and a tentative agreement with Ukraine on an Extended Fund Facility (EFF) of SDR 1.6 billion ($2.2 billion, equivalent to 165% of quota) reduce holdings in the General Resources Account (GRA) to 19.7 billion (about $26.1 billion, as of August 24, 1998.) This does not include funds obtained through activating the GAB to finance the augmentation of Russia's extended arrangement.

Among the countries that have been under financial pressure recently are Malaysia, South Africa, Venezuela, and Brazil. Under current access limits, IMF

members can borrow 100% of their quotas annually and 300% cumulatively. (Most of the recent loans have exceeded current access limits.) As of May 31, Malaysia had a reserve position (creditor) position in the IMF and, thus, potentially, could borrow an amount equal to its quota or SDR 832.7 million in the first year. South Africa had a negligible reserve position, but also outstanding credit of SDR 230.4 million (16.9% of quota). While its previous borrowing would affect the cumulative total, it could also borrow 100% of quota in the first year or SDR 1,365.4 million. Brazil, with only SDR 15.5 billion in outstanding loans (0.7% of quota) could also borrow its full quota of SDR 2,170.8 million. Venezuela is in a somewhat less fortunate position. It owes the IMF SDR 1,156.5 million (59.3% of quota). Although this would be subtracted from its cumulative limit, it too could borrow 100% of its SDR 1,591.3 million quota in the first year. Taken together these four countries alone could potentially request SDR 5,960.2 million ($7.9 billion) and still remain within current access limits.

The Role of Congress

The dollar equivalent of the SDR 2,462 million funding required for U.S. participation in the NAB is scored in the FY 1999 budget as $3.4 billion.[16] Under budgetary and accounting practices established in consultation with Congress in 1980, this will require budgetary authorization and appropriation in the full amount.[17]

As with the GAB, funds provided to the IMF under the NAB are provided upon call. A budget expenditure occurs only as cash is actually transferred to the IMF. If a transfer is made, the United States receives an equal, offsetting receipt — an interest-bearing international monetary asset. In budgetary terms, however, offsetting transactions are treated as an exchange of assets. As a consequence, they do not result in **net** budget outlays, and they do not affect the net budgetary position of the U.S. government irrespective of whether it is in deficit or in surplus.

Federal budget policies are generally enforced under two sets of procedures. First, a concurrent resolution on the budget sets forth spending levels that are enforced by points of order when legislation is under consideration. Second, the Balanced Budget and Emergency Deficit Control Act of 1985, as amended ("Gramm-Rudman") establishes discretionary spending limits and a pay-as-you-go (PAYGO) requirement that restrain action on annual appropriations measures and on mandatory spending and revenue measures, respectively. Any violations of the discretionary spending limits or the PAYGO requirement are enforced at the end of a congressional session by a sequester, that is, by across-the-board spending cuts.

The IMF is currently exempted from both sets of federal budget enforcement procedures. Section 314 of the Congressional Budget and Impoundment Control Act

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[16] U.S. Executive Office of the President. Office of Management and Budget. *Budget of the United States Government, Fiscal Year 1999. Appendix*, p. 970.

[17] Additional information may be found in CRS Report 96-279 E, *U.S. Budgetary Treatment of the International Monetary Fund*, and in CRS Report 98-412 E, *International Monetary Fund (IMF): Costs and Benefits of U.S. Participation*, both by (name redacted).

of 1974 requires that the chairmen of the House and Senate Budget Committees adjust various limits and allocations under a budget resolution for certain factors, including, in Sec. 314 (b)(3), increases due to enactment of IMF funding.[18] The IMF is, thus, exempted from budget resolution controls.

The IMF is also exempted from statutory spending limits by a requirement that the limits be increased by the amount of the IMF funding. Section 251 (b)(2)(D) of the 1985 Balanced Budget, as amended, requires that the statutory discretionary spending limits be increased by the amount of IMF appropriation act.[19]

Although funding for the IMF has no impact on the federal fiscal position and is exempted from the budgetary enforcement procedures, it is, nevertheless, subject to the appropriations process. IMF funding is considered with the foreign operations appropriation. Historically, this has provided Congress with an opportunity to exercise vigorous oversight of the IMF, its programs, and operations.

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[18]This section was added by Sec. 10114 (111 Stat. 688-690) of the Budget Enforcement Act (BEA) of 1997. The BEA of 1997 is Title X of P. L. 105-33, the Balanced Budget Act of 1997.

[19]This section was amended most recently by Sec. 10203 (111 Stat. 698-702) of the Budget Enforcement Act (BEA) of 1997.

Appendix I: The "Illiquidity Ratio"

Upon becoming a member of the IMF or at the time of a quota increase, IMF members must pay in 25% of their quota or quota increase in hard currency or SDRs. This represents the IMF's paid-in capital. It also constitutes an international reserve asset of the member country and is, therefore, known as the "reserve tranche." The remaining 75% of a member's quota subscription or quota increase does not have to be paid-in, but is callable. The United States, for example, provides the callable share of its quota in the form of a non-interest bearing, non-negotiable letter of credit that may be accessed on demand by the IMF.

Movements in the reserve tranche positions of member countries reflect financial activity within the IMF. As the IMF draws upon callable capital for use in its loan operations, the reserve tranche of the member country whose currency is drawn or "called" will increase by an equivalent amount. Its reserve tranche then will rise above the level of paid-in capital (equal to 25% of quota). The IMF only draws on the callable capital of member countries that are in strong balance-of-payments positions. By comparison, countries that are not in a strong external financial position may withdraw their reserve tranche (paid-in capital) automatically and unconditionally upon presentation of a balance-of-payments need, and many countries do. Indeed, some poorer countries withdraw their reserve tranche immediately after becoming IMF members. Their right to do this arises from the fact the reserve tranche is legally considered to be a part of a country's international reserve assets.

For example, as of May 31, 1998, the industrial countries had provided resources to the IMF that more than compensated for withdrawals by the developing countries. The industrial countries had reserve tranche positions of SDR 45,925.6 million ($61.3 billion), compared to their paid-in capital requirement of SDR 22,106.3 million ($29.5 billion). Looked at another way, the IMF had tapped SDR 23,819.3 million ($31.8 billion) in callable resources provided by the industrial countries. By comparison, the developing countries that are IMF members had quotas amounting to SDR 56,895.8 million (about $76.0 billion, as of May 31). Paid-in capital or the reserve tranche for the developing countries would be equal to SDR 14,223.95 million ($19.0 billion) In fact, however, the developing country members of the IMF, as a group, had a combined reserved tranche position of SDR 5,851.9 million ($7.8 billion), that is, as a group, they had drawn down SDR 8,372.1 million ($11.2 billion) or 58.9% of their paid-in capital.

In **text figure 1** on page 10 of this report, when the reserve tranche positions for all IMF member countries, taken together, are equal to their paid-in capital (25% of all IMF quotas, the 100% mark in text figure 1), the IMF is, on a net basis, in a financially neutral position. When reserve tranche positions fall below an amount equal to paid-in capital, some member countries have withdrawn all or part of their reserve tranche. Total reserve tranche positions have fallen below the 100% mark, but the IMF has not had to draw on its callable capital in order to allow them to do that. In addition, the IMF is also able to fund any loan operations from paid-in capital. Although the IMF is becoming relatively less liquid, it is not particularly financially constrained because it has sufficient paid-in capital to cover its needs. On

the other hand, when reserve tranche positions begin to exceed paid-in capital, the IMF is tapping callable capital to fund its operations. It is once again becoming relatively less liquid, but the manner in which it funding its operations has changed — from paid-in capital solely to paid-in plus callable capital. The "illiquidity ratio" rises above 100%. Thus, the higher the ratio rises above 100%, the more seriously constrained are the IMF's finances.

A major feature of the ratio shown in text figure 1 is that it does not involve any type of adjustment or allowance for the amount of financial resources that the IMF must have available for future contingencies. Rather this ratio makes no judgement on this highly contentious issue. Data used by CRS for this ratio are "hard," bookkeeping, or accounting numbers. Considering only quota-based resources, the IMF is simply more financially constrained the higher the ratio moves above the 100% level. For this reason, and to distinguish it from the IMF's ratio, it is dubbed the "illiquidity ratio."

A second feature of the ratio is that its components are fundamental to the IMF's operations, are published monthly, and have been publicly available for a long time. Using published data available to CRS, the data series could be run back to 1950, not too many years after the IMF first began its loan operations. To achieve this 48-year time series, calendar-year data were used. Alternatively, end of IMF fiscal-year data could have been used. Data for building a similarly long time-series using end-of-IMF-fiscal-year data were not, however, available within CRS. By comparison, the IMF's "liquidity ratio," is only available annually, published in the IMF's *Annual Reports* every year since 1990.

A disadvantage of the "illiquidity" ratio is that a two-month lag still remains, reflecting the normal lag in publication of the data for reserve position in the IMF's *International Financial Statistics* (IFS). In less volatile times, this would not be of particular importance; in the midst of a major international financial crisis, however, it is a drawback. CRS has taken advantage of data provided by IMF Treasurer David Williams in his press conference of July 13, 1998 to update the ratio to this latter date.

Finally, the ratio does not take into account the impact of borrowed resources. During some periods they have provided a significant amount of resources to the IMF. All previous borrowings, however, were repaid by 1996. At present the IMF has access to SDR 17.0 billion (currently about $22.5 billion) under the GAB, of which SDR 6.3 billion (about $8.3 billion) were recently activated for the assistance package for Russia. For some time now, reserve tranche positions and outstanding fund credit have been moving in rough tandem. The activation of the GAB takes some pressure off the IMF's general resources and alters the direct relationship between reserve tranche positions and outstanding fund credit. As a result, the "illiquidity ratio"is likely to stabilize.

Ratios are presented in **appendix table 1** on the next page.

Table 1a. Ratio of Reserve Tranche Positions to Paid-In Capital (Illiquidity Ratio), CY 1950-May 1998

(Percent)

Year	Ratio	Year	Ratio	Year	Ratio	Year	Ratio
1950	83.2	1963	107.7	1976	182.0	1989	114.2
1951	85.2	1964	113.4	1977	185.6	1990	104.2
1952	88.2	1965	102.6	1978	99.5	1991	113.6
1953	94.2	1966	121.0	1979	78.9	1992	95.9
1954	91.7	1967	109.7	1980	113.0	1993	90.6
1955	85.9	1968	123.8	1981	143.1	1994	87.7
1956	103.8	1969	128.4	1982	170.8	1995	101.2
1957	105.6	1970	106.9	1983	175.3	1996	104.6
1958	116.6	1971	88.3	1984	186.3	1997	129.6
1959	88.8	1972	87.9	1985	173.6	7/13/98	144.9
1960	97.5	1973	85.6	1986	158.4	—	—
1961	113.4	1974	122.9	1987	141.0	—	—
1962	103.6	1975	175.5	1988	126.7	—	—

Source: Calculated from IMF. *International Financial Statistics*. Various yearbook and monthly editions.

Years in which quota increases adopted are shaded. Dates of entry into effect, as follows: April 6, 1959; February 23, 1966; October 30, 1970; April 1, 1978; November 29, 1980; November 30, 1983; and November 11, 1992.

Appendix II: A Comparison of CRS' Illiquidity Ratio and the IMF's Liquidity Ratio

Graphic presentations of CRS' illiquidity ratio and the IMF's liquidity ratio are shown immediately below. *It is important to remember in looking at the two graphs that they will move in opposition directions when showing the same thing*. Thus, in **figure 2**, CRS' illiquidity ratio, a **rising** ratio indicates that the IMF is becoming increasingly illiquid; in **figure 3**, the IMF's liquidity ratio, a **falling** ratio indicates that the IMF is becoming increasingly illiquid. For comparability, the data for both graphs are presented on an IMF fiscal-year basis, that is, ending April 30 of each year, except for December 31, 1997 and July 13, 1998. The two sets of ratios are also presented in **appendix table 2** at the end of this section. *Because the two ratios are constructed differently, the resulting ratios also differ numerically.* This outcome is implicit in their construction and entirely expected.

Figure 2. CRS Illiquidity Ratio, IMF FY 1990-July 1998

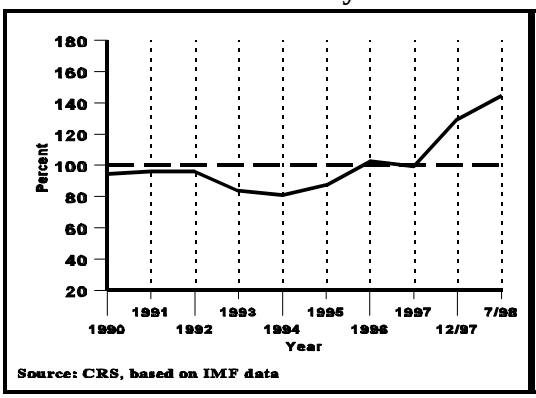
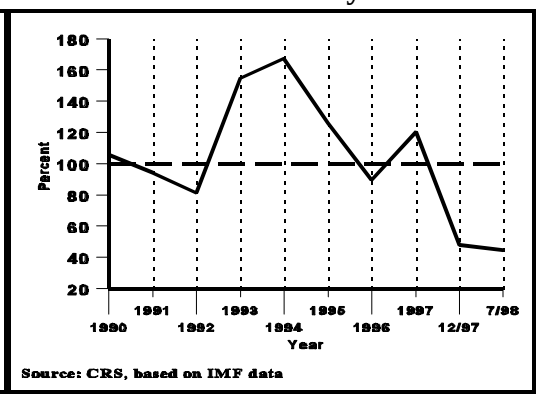


Figure 3. IMF Liquidity Ratio, IMF FY 1990-July 1998



Comparison of the two graphs allows a few conclusions to be drawn:

- both ratios show that the IMF was in a fairly liquid financial position from April 1993, just following approval of a quota increase in late 1992, through April 1997,

- both ratios show that between April 1997 and December 1997 the IMF became increasingly illiquid and that this deterioration has continued in 1998,

- both ratios show that the IMF is now more illiquid than at any time during the nearly 8 ½ years period, and

- the CRS ratio shows somewhat less variability than the IMF's liquidity ratio, but, over the entire period, the outcome does not differ greatly. From 1990 to July 1998, with a base year of 1990 as 100, an index for CRS's "illiquidity ratio"rose by 53.2%, while an index for the IMF's "liquidity ratio" fell by 57.7%.

From an analytical perspective, the somewhat greater variability in the IMF ratio is not surprising; it is implicit in the construction of the ratio itself. The numerator

of the IMF's liquidity ratio consists of "uncommitted and adjusted usable resources." The IMF adjusts the numerator to reflect its need to maintain working balances of currencies and to reflect the possibility that the currencies of some members in relatively weaker external positions might have to be removed from the operational budget. (The latter consists of the currencies of about 30 countries that the IMF uses in its operations. The IMF maintains confidentially regarding which currencies are included in its operational budget. The removal of a weak currency from the operational budget might provide an adverse signal to private financial markets.) Since February 1998, the adjustment factor applied to the numerator has been set at 10% of the quotas of members whose currencies are used in the operational budget. Neither of these two adjustment factors are a matter of public record, nor can they readily be estimated or calculated. The resulting number for "uncommitted and adjusted usable resources," nevertheless, represents the IMF's judgement on the amount of resources it has available for future loan operations.

The denominator of the IMF's "liquidity ratio" consists of the IMF's liquid liabilities, which consists of reserve tranche positions of IMF members and, before 1996 and after July 1998 (when the GAB were activated), also of loan claim against the IMF, that is, the IMF's borrowings from member countries to supplement it resources.

Although the IMF has published it "liquidity ratio" only since 1990, it has reported the parameters of movements in earlier years. According to the IMF, the "liquidity ratio" ranged between 71.0% and 108.5% at the end of each of its fiscal years 1983 to 1989.[20] According to IMF Treasurer Williams, the lowest liquidity ratio that the IMF has experienced was 30%.[21]

Table 2a. CRS Illiquidity Ratio and IMF Liquidity Ratios, IMF FY 1990 - July 1998

IMF Fiscal Year	CRS Illiquidity Ratio	IMF Liquidity Ratio	IMF Fiscal Year	CRS Liquidity Ratio	IMF Liquidity Ratio
1990	94.5	105.6	1995	87.5	126.6
1991	95.9	94.0	1996	102.8	89.8
1992	95.9	81.6	1997	99.4	120.5
1993	83.7	154.9	Dec. 1997	129.6	47.8
1994	81.0	167.9	July 1998	144.9	44.7

Source: CRS, from IMF data.

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[20] *Annual Report*, 1990, p. 51

[21] Press conference, July 13, 1998.