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# International Monetary Agreements Amendment Bill (No. 1) 2010

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# International Monetary Agreements Amendment Bill (No. 1) 2010

**Date introduced:** 16 June 2010

**House:** House of Representatives

**Portfolio:** Treasury

**Commencement:** The operative provisions (Schedule 1) commence on the later of:

- Royal Assent, or
- the date on which amendments to the International Monetary Fund's 'New Arrangements to Borrow' arrangement and changes in credit arrangements of existing participants in this arrangement referred to in Decision No. 14577-(10/35) of the Executive Board of the International Monetary Fund (dated 12 April 2010) (the IMF decision) becomes effective.

**Links:** The links to the Bill, its Explanatory Memorandum and second reading speech can be found on the Bills page, which is at http://www.aph.gov.au/bills/. When Bills have been passed they can be found at ComLaw, which is at http://www.comlaw.gov.au/.

## Purpose

This Bill amends the *International Monetary Agreements Act 1947* (IMA Act) to allow Australia to accept the changes to the terms and conditions of the 'New Arrangements to Borrow' (NAB) of the International Monetary Fund (IMF) adopted by the Executive Board of that agency on 12 April 2010. The proposed amendments will allow Australia to make larger sized loans to the IMF, under the recently decided changes to the NAB, in the event that the Fund calls for additional finance.[1]

## Background

### How does the IMF work?

To understand what the NAB is, it is necessary to understand how the IMF operates. The IMF is a specialised agency of the United Nations and has 186 member countries. Amongst other things, it provides policy advice and financing (lending) to member states in economic difficulties. It is the funding of this latter function that is the special focus of this Bill.

1. C Emerson (Minister for Competition Policy and Consumer Affairs), 'Second reading speech: International Monetary Agreements Amendment Bill (No. 1) 2010', House of Representatives, *Debates*, 16 June 2010, p. 5; Explanatory Memorandum, International Monetary Agreements Amendment Bill (No. 1) 2010, p. 1.

Upon joining, each member of the IMF is assigned a financial contribution quota, based broadly on its relative size in the world economy. A member's quota subscription determines the maximum amount of financial resources the member is obliged to provide to the IMF. A member must pay its subscription in full upon joining the organization: up to 25 per cent must be paid in the IMF's own currency, called Special Drawing Rights (SDRs) or widely accepted currencies (such as the dollar, the euro, the yen, or pound sterling), while the rest is paid in the member's own currency.[2] Australia's quota is SDR3.2 billion and the United States, as the largest member, has a quota of SDR37.1 billion.[3]

The IMF's second source of funds is its gold holdings. It was, as at January 2010, the world's third largest official gold holder, with just over 3000 tonnes in its possession. However, in the fourth quarter of 2009 the IMF initiated the first phase of a program to sell 403 tonnes of gold.[4]

### What is the NAB?

The IMF's third source of funding is borrowing additional amounts from its members. While quota subscriptions of member countries are the IMF's main source of financing, the Fund can supplement its resources through borrowing if it believes that resources might fall short of members' needs. Through the General Arrangements to Borrow (GAB) and the New Arrangements to Borrow (NAB), a number of member countries and institutions agree to stand ready to lend additional funds to the IMF.

The NAB is a set of credit arrangements between the IMF and 26 member countries and institutions.[5] In January 1997, the IMF's Executive Board adopted a decision establishing the NAB, which became effective in November 1998. The NAB has been renewed twice, most recently in November 2007 for a further period of five years from November 2008.

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2. Material for this section is drawn from IMF, About the IMF, *Overview*, viewed 18 June 2010, http://www.imf.org/external/about/overview.htm. The SDR was created in 1969. It is an international reserve asset and is based on a basket comprised of the British pound, the euro, Japanese yen and the United States dollar, but its value is measured in US dollars daily.

3. P Bayley, 'When the IMH says it will rescue Greece, we all provide the funding', *Banking Day*, 21 May 2010, viewed 19 June 2010, http://www.bankingday.com/nl06_news_selected.php?act=2&stream=1&selkey=9888&hlc=2&hlw=. Also see E Doherty (Reserve Bank of Australia – International Department), 'IMF initiatives to bolster funding and liquidity', *Reserve Bank Bulletin*, Sydney, November 2009, viewed 19 June 2010, http://www.rba.gov.au/publications/bulletin/2009/nov/2.html

4. P Bayley, ibid.

5. The list of these countries and institutions, including those participating under the 'expanded' NAB, is at http://www.imf.org/external/np/exr/facts/gabnab.htm viewed 19 June 2010.

### Expanding the NAB

As a key part of efforts to overcome the global financial crisis, on 2 April 2009, the Group of Twenty industrialized and emerging market economies (G 20) agreed to increase the resources available to the IMF by up to an additional US$500 billion. This new amount represents a trebling of the total pre-crisis lending resources of about US$250 billion, and is aimed at being supportive of growth in emerging market and developing countries.

On 24 November 2009, the current 26 NAB participants and representatives of 13 potential new participants reached agreement on the key elements of an expanded and more flexible NAB. It was proposed that the NAB be expanded up to US$600 billion. A formal decision on the expanded and more flexible NAB was taken by the Executive Board of the IMF on 12 April 2010.

To make the expanded NAB operational, current NAB participants need to consent to the proposed amendments to the latest NAB decision and the increases in credit arrangements, and new participants need to notify the IMF of their adherence to the NAB. For many current and future NAB participants this involves domestic approval procedures, including legislative approval before they can consent or adhere to the expanded NAB. This Bill contains legislative provisions that allow Australia to participate in the expanded NAB.[6]

The Explanatory Memorandum notes that the recent amendments to the NAB will become effective when existing NAB participants representing 85 per cent of total credit arrangements have concurred to these changes, including each participant whose particular credit arrangement has been changed.[7] Apparently, this level of agreement has not yet been reached.

A particular feature of this expansion is that for the first time China, Russia, India, Brazil and nine other countries have agreed to participate in these expanded arrangements, alongside the 26 other countries (including Australia), that have already extended additional credit to the IMF.[8]

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6. Material in this and the preceding section was drawn from IMF, *IMF standing borrowing arrangements*, Factsheet, 14 April 2010, viewed 18 June 2010, http://www.imf.org/external/np/exr/facts/gabnab.htm

7. Explanatory Memorandum, p. 2.

8. H Schneider, 'IMF triples crisis loan pool to $500b', *Sydney Morning Herald*, 14 April 2010, p. 7.

The IMF is not the only organisation expanding its lending capacity in the face of the global financial crises. Both the World Bank and the Asian Development Bank have put new arrangements in place to respond to this crisis.[9]

### Additional IMF funding

Lastly, the IMF implemented a note issuance facility in July, 2009. The IMF can now issue notes (or bonds) to the 'official sector' of member countries, that is, their central banks and, or monetary authorities.

The notes provide the official sector with a safe investment and help ensure the IMF can provide timely and effective assistance to countries in need. To date, three note purchase agreements have been signed with member countries, with a total a total value of US$69 billion.

Clearly, the IMF's ability to fund its activities comes directly from the strength of the economies of its members.[10]

## Basis of policy commitment

The proposed amendments were foreshadowed in the Treasurer's media release of 12 May 2009.[11]

## Committee consideration

As at the date of writing this Bill has not been referred to a parliamentary committee for inquiry.

## Position of significant interest groups/press commentary

There has been little Australian comment on this Bill. However, some international comment suggests that the expanded NAB may lead to global inflation, if these arrangements are called upon.[12] Another commentator suggests that the expanded NAB

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9. Australian Government, AUSAid, '*Global recession update',* no. 5, 5 August 2009, viewed 19 June 2010, http://www.ausaid.gov.au/makediff/pdf/recession_update_5.pdf

10. P Bayley, op. cit. See also N Roubini, 'IMF funding: SRD bonds likely to boost lending capacity', Roubini Global Economics, *Briefing note*, 1 July 2009, viewed 19 June 2010, http://www.roubini.com/briefings/10512.php

11. W Swan (Treasurer), *Australian commitments to International Monetary Fund and Asian Development Bank*, media release, No. 064, Canberra, 12 May 2009, viewed 18 June 2010, http://www.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2009/064.htm&pageID=003&min=wms&Year=2009&DocType=0

12. M DeFault, 'IMF prepares for global cataclysm', Bullionmark website, 15 April 2010, viewed 19 June 2010, http://bullionmark.com.au/bullion-market-tools-a-

enables IMF members to 'lend to themselves' and so represents a very large government sanctioned 'Ponzi Scheme'.[13] Generally, such schemes eventually collapse.

Still other commentators are wary of the IMF and its role in offering financial support to struggling governments due to perceptions of its requirement for overly harsh economic policies that have in the past accompanied its loans. They are wary of the expansion of the NAB and the Fund's ability to provide additional loans (if called upon) for this reason.[14]

### Pros and cons

The ability of multilateral institutions, such as the IMF to provide finance to countries that find themselves in financial difficulties is a stabilising influence in current circumstances. A stable international financial environment is very much in Australia's interests, enabling higher levels of international trade and investment to occur than would otherwise be the case.

However, the proposed amendments represent a potential additional substantial call on government finances. Currently, the government is seeking to reduce its outstanding debt. Any additional call by the IMF on Australia for additional funds would further complicate this particular task. The risk of this disadvantage depends on the probability that the IMF will indeed make such a call. Recently, several of the most indebted European states have reduced their budget spending, and increased taxes, in an effort to reduce their outstanding debt levels.[15] Whether these actions will be enough to avoid the need for the provision of

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resources/2010/4/00/64-IMF-prepares-for-GLOBAL-CATACLYSM.html Caveat: this site does not present an unbiased opinion. Rather its opinions seem aimed at boosting the demand for physical gold holdings. Nevertheless, it is a current opinion in relation to the expanded NAB.

13. P Amery, 'The ultimate Ponzi scheme', Index Universe Europe website, 16 April 2010, viewed 19 June 2010, http://www.indexuniverse.eu/blog/7393-the-ultimate-ponzi-scheme.html. As readers may be aware, a 'Ponzi scheme is one where interest and dividend payments to investors are made from the capital contributed by those investors. The most recent example of such a scheme is the large scale fraud recently uncovered in the US run by Bernie Madoff.

14. 'The IMF's new lease of life: A bad idea?', Share the world's resources website, *IMF World Bank and Trade*, 28 April 2009, viewed 19 June 2010, http://www.stwr.org/imf-world-bank-trade/the-imfs-new-lease-of-life-a-bad-idea.html. R Weissman, 'A new life for the IMF: Capitalizing on crisis', Towards Freedom website, 1 July 2009, viewed 19 June 2010, http://www.towardfreedom.com/globalism/1612-a-new-life-for-the-imf-capitalizing-on-crisis

15. For example, Spain has recently announced a substantial tax increases, B Dominguez, 'Tax hikes in Spain's 2010 budget', Baker and McKenzie website, 2010, viewed 19 June 2010, http://www.bakermckenzie.com/FCSpainTaxHikes2010Budget/. 'Spain's deficit to decline in 2010 government says', *Latin American Herald Tribune*, 18 June 2010, viewed 19 June 2010, http://laht.com/article.asp?ArticleId=351632&CategoryId=12396

substantial financial support to heavily indebted nations remains to be seen. Further, the provision of such support does not necessarily mean that the additional financial commitments under the NAB will be called upon.

Another potential problem with the proposed arrangements is that the overall size of the NAB has been noted as being far larger than the amount that may be required to be provided as financial support for heavily indebted nations.[16] It may be the case that the scale of commitments that Australia is undertaking, is far higher than what is actually needed to provide the IMF with adequate financial resources for his task.

The counter argument to this point is that other potential lenders to heavily indebted countries will consider such activity less risky (and therefore continue such lending) if they are assured that their funds will be repaid. One way of achieving this outcome is to provide a substantially larger pool of potential funds available to heavily indebted countries to be used as a last resort. The existence of this pool of potential finance provides confidence to other lenders to these countries so that such lending can continue, thereby reducing the chance that the NAB funds will called upon at all.

## Financial implications

As the Bill's provisions only allow Australia to respond to any MF call for additional finance for the NAB, and not actually provide that finance, the proposed amendments do not have a direct budget impact.

However, the Explanatory Memorandum notes that should the proposed amendments become law the IMF will be able to call upon Australia for up to SDR4370.41m, an increase of SDR3569.12m from the existing commitment level of SDR801.29m (or an increase of 445.42 per cent).[17]

As at 19 June 2010, SDR4370.41 million was $A7393.2m.[18]

The Explanatory Memorandum also notes that in the event of Australia's commitment being called upon this loan would be repaid in full, with interest, within five years.[19]

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16. 'Dip into our pockets, IMF', *Herald Sun*, 17 June 2010, p. 20; H Schneider, op. cit.
17. Explanatory Memorandum, p. 2.
18. Calculation undertaken at following exchange rate: 1 SDR = 1.69164 AUD. Exchange rate sourced from http://www.xe.com/ucc/
19. Explanatory Memorandum, p. 2.

## Main provisions

**Clause 2** of the Bill provides that the proposed amendments to the IMA Act will apply from the later of:

- Royal Assent, or
- when existing NAB participants (including Australia), representing 85 per cent of total credit arrangements have concurred to the amendments adopted by the IMF Executive board, including each participate whose credit arrangement is changed.

Several important points arise from this clause:

- the granting of Royal Assent will not automatically allow these amendments to enter into force. Rather their date of effect depends on the decisions of the existing NAB participants, in particular all those whose credit arrangements have been changed (that is, increased). Unless all such countries agree Australia's increased commitment cannot enter into force, and
- the date on which these amendments take effect does not depend on the decisions of the new NAB participants noted above (that is China, Russia, India and Brazil etc).

### Schedule 1

**Item 1** amends subsection 3(1) of the IMA Act so that this Act's NAB definition is exactly the same as the IMF decision noted above.

**Item 5** repeals the existing Schedule 4 of the IMA Act and inserts a **new Schedule 4** in its place.

The content of the **proposed Schedule 4** is the text of the IMF decision noted above. In particular Annex I of that decision increases Australia's credit arrangements from SDR801.29m to SDR4370.41m.

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