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# International Monetary Agreements Amendment Bill (No. 1) 2000

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# International Monetary Agreements Amendment Bill (No. 1) 2000

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Law and Bills Digest Group
27 November 2000

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# International Monetary Agreements Amendment Bill (No. 1) 2000

**Date Introduced:** 12 October 2000

**House:** House of Representatives

**Portfolio:** Treasury

**Commencement:** Royal Assent. Schedule 1 commences on Proclamation or six months after the commencement of the Fourth Amendment to the Articles of Agreement of the International Monetary Fund.

## Purpose

To amend the *International Monetary Agreements Act 1947* in order to reflect changes to the principal international instrument which will consolidate the arrangements for a new allocation of special drawing rights (SDRs) among member nations of the International Monetary Fund (IMF).

## Background

### The IMF

The International Monetary Fund (IMF), along with the International Bank for Reconstruction and Development (World Bank) and the General Agreement on Trade and Tariffs (GATT), was established at the United Nations Monetary and Financial Conference held at Bretton Woods in July 1944. The legal authority for the IMF is drawn from its *Articles of Agreement*, a treaty which came into force in December 1945.

The IMF and World Bank were created to 'oversee stability in international monetary affairs and to facilitate the expansion of world trade'.[1] They were also intended to 'institute policies that would avoid "beggar-thy-neighbour" protectionism and provide mechanisms to supply capital for post-war reconstruction'.[2] In particular, the IMF was established to:

- promote international monetary cooperation

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- facilitate the expansion and balanced growth of international trade
- promote exchange stability
- assist in the establishment of a multilateral system of payments
- provide support for countries experiencing temporary balance of payments difficulties
- provide temporary credit to members with balance of payments difficulties, and
- manage disequilibrium in the international balances of payments of members.[3]

Originally, the IMF had two key functions: exchange stability and balance of payment support. Exchange stability was to be achieved by establishing a fixed exchange rate system. Exchange rates would be fixed according to a par value system where the value of each currency was defined in terms of gold or the US dollar (itself defined in terms of gold). A member's exchange rate could be adjusted but only by consent among the other members. Balance of payments support was to be achieved by establishing a common pool of reserves among member currencies. Each member nation would be allocated a quota in accordance with its national income, trade and other economic indicators. Members would make a financial commitment to the pool according to the quota and receive corresponding voting rights. One quarter of the quota was to be paid in gold or a convertible currency and the remaining three quarters was payable in domestic currency. Each member would be able to withdraw one quarter of its quota and to borrow up to three times its quota.

An extended account of the history and background of the IMF is given in a digest of the International Monetary Agreements Amendment Bill 1998 (*Bills Digest No. 165 1997-98*).

## The SDR

### History

While the system provided some stability, it also proved to contain potential limits. The reliance on gold and the US dollar meant that the system was subject to instability. The supply of gold was affected by production limitations and speculation in the commodities market. The supply of US dollars was affected by US economic policies and whether they caused a flow of $US from the US to the rest of the world. Nations had used foreign reserves to support the par-value of their domestic currency under the fixed exchange rate system. Inevitably, some nations were caught short and required IMF support.

Various solutions were proposed to address fears of a shortage of international liquidity. One solution was to abandon the fixed exchange rate system, but this was rejected apparently because the advantages would be 'accompanied by the uncertainties that fluctuating rates would produce'.[4] Another solution was to increase the price of gold, but this was rejected for a number of reasons, including the fact that there would be an 'irrational distribution of direct profits' from gold production.[5] A third solution was to

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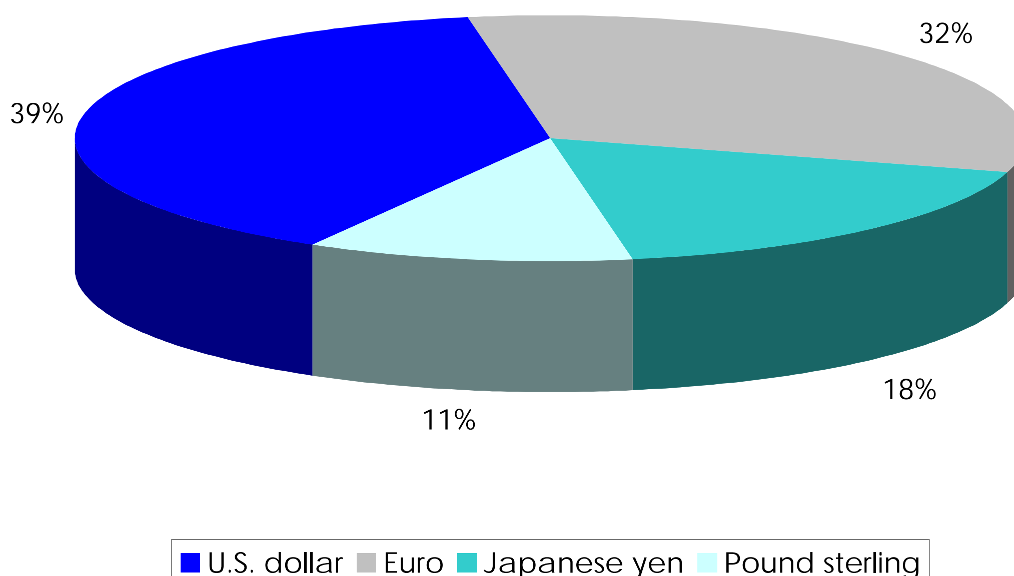
increase quotas of members, but this was rejected because it would have increased, in an unprincipled way, the ability of members to borrow from the common pool.[6] (As it happened, the imbalances of the 1970s caused some countries to take unilateral action and float their currencies. Ultimately, the fixed exchange rate system was abandoned.)

In 1969 the *First Amendment of the Articles of Agreement* attempted to address fears of a shortage of international reserves by creating an artificial reserve asset, the *special drawing right* (SDR). The SDR is a convertible interest bearing asset which is allocated to each member in proportion to its quota. While it is really only a paper assets created by the IMF, the SDR is underwritten by common undertakings that SDRs will be honoured with equivalent reserve assets in trade and other transactions. Its value is determined according to a weighted basket of four currencies: US dollar, Pound Sterling, Euro and Japanese Yen (see the figure below). Currently, one SDR is currently worth just under A$2.50.[7]

**Valuation of the SDR (%)**




■ U.S. dollar ■ Euro ■ Japanese yen ■ Pound sterling

Since the *First Amendment of the Articles of Agreement*, there have been two amendments. The *Second Amendment of the Articles of Agreement* in 1978 sought to abandon the official use of gold, engender cooperation among members regarding policies on reserve assets and to entrench the SDR as the principal reserve asset of all members. (The *Third Amendment of the Articles of Agreement* in 1992 empowered the IMF to suspend voting rights of members who were in breach of obligations under the *Articles of Agreement*.)

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### Reviews of Quotas

The IMF is required under the *Articles of Agreement* to conduct general reviews of quotas at least once every five years (Article III). (A member may, on its own motion, request an adjustment of its own quota.) Based on the general review, the IMF may, 'if it deems it appropriate', propose a global adjustment to members' quotas. To be effective the proposal must be endorsed by a vote of members carrying 85 percent of the total voting power (based on the relative shares of quotas). To date, there have been eleven general reviews.

### General and Special Allocations

The IMF also has authority under the *Articles of Agreement* to make *general* allocations of SDRs '[t]o meet the need, as and when it arises, for a supplement to existing reserve assets' (Article XV). The IMF must only address 'long-term global need' and must do so 'in such manner as will promote the attainment of its purposes and will avoid economic stagnation and deflation as well as excess demand and inflation in the world' (Article XVIII). General allocations are made in 'basic periods' of up to five years. To date, two general allocations have been made, one in the basic period 1970-1972 and the other in 1978-1981:

**General Allocations of SDRs**

| *Basic Period* | *Allocations (SDR billion)* |
|---|---|
| 1970-1972 | 9.3 |
| 1978-1981 | 12.1 |
| **Total** | **21.4** |

### Conditional and Unconditional Liquidity

Ironically, despite the intention behind the *First* and *Second Amendments* the major facility provided by the IMF is in relation to conditional liquidity. Given the 'relatively small volume of cumulative allocations', the SDR has not contributed significantly to world liquidity (in 1998 SDRs accounted for only about 1.7 percent of convertible reserves held in the IMF). Also, given the fact that SDRs can only be held and traded by official entities, it has played a 'rather limited' role as a medium of exchange.[8] In addition given the globalisation of international finances and the growth of private capital markets, the SDR may be unlikely ever to become a principal reserve asset for IMF members.[9]

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## The Equity Issue

### Allocations

Given the linkage between quotas and allocations, inevitably there will be large differences in the allocations held by members based on their relative economic position. The differences are largely reflected in the current distributions of allocations:

**Distribution of Allocations – Selected Countries[10]**

| *Top Ten* | | *Bottom Ten* | |
|---|---|---|---|
| *Member* | *Allocation* | *Member* | *Allocation* |
| United States | 4,899,530,000 | Samoa | 1,142,000 |
| United Kingdom | 1,913,070,000 | Grenada | 930,000 |
| Germany | 1,210,760,000 | St. Lucia | 741,600 |
| France | 1,079,870,000 | Comoros | 716,400 |
| Japan | 891,690,000 | Solomon Islands | 654,400 |
| Canada | 779,290,000 | Cape Verde | 620,000 |
| Italy | 702,400,000 | Sao Tome & Principe | 620,000 |
| India | 681,170,000 | Dominica | 592,400 |
| Netherlands | 530,340,000 | Seychelles | 406,400 |
| Belgium | 485,246,000 | St. Vincent | 353,600 |
| Australia | 470,545,000 | Maldives | 282,400 |

### The Equity Issue

The current distribution of SDRs is not entirely in proportion to quotas. As early as 1993 concern had been raised regarding the inequity among members in the *ratio* of SDRs to quotas. As indicated, general allocations of new SDRs are made in proportion to quotas consistently across all participating members. However, significant differences had emerged following the last general allocation. Some members had not participated in the allocation and therefore began at a disadvantage. Other members had improved their economic position and their quotas had increased without a corresponding increase in their

allocation. A total of 39 new members had joined and had not been granted *any* allocation (These were mostly countries in transition since the breakdown of the Soviet Union.[11]) Thus, while the average ratio of allocations to quotas is currently around 9.63 percent,[12] the variance is around 6.89 percent. It is interesting to note that the lowest ratio (1.91 percent) is held by Singapore and the highest ratio is held by Somalia (30.99 percent). This reflects the fact that quotas are determined by current economic 'weight' but SDR allocations reflect 'weights' at earlier periods. Hence, countries growing more quickly than average have a lower allocation than current 'weight' would suggest.

**Distribution of Allocations/Quotas Ratios[13]**

| *Top Ten* | | *Bottom Ten* | |
|---|---|---|---|
| *Member* | *Ratio* | *Member* | *Ratio* |
| **Somalia** | **30.99%** | Seychelles | 4.62% |
| Sudan | 30.76% | Bahrain | 4.59% |
| Congo | 29.66% | Korea | 4.46% |
| Liberia | 29.46% | St. Vincent | 4.26% |
| Laos | 24.06% | Maldives | 3.44% |
| Haiti | 22.57% | Oman | 3.23% |
| Afghanistan | 22.18% | Zimbabwe | 2.89% |
| Equatorial Guinea | 17.83% | Saudi Arabia | 2.80% |
| United Kingdom | 17.82% | Lebanon | 2.16% |
| Burundi | 17.79% | Kuwait | 1.94% |
| Cambodia | 17.62% | **Singapore** | **1.91%** |

One possible solution was to make a general allocation of SDRs to all members. However, as indicated, a general allocation must be based on the existence of 'long-term global need' and despite growing awareness of the differences, there was no consensus on the existence of 'long-term global need' or that a solution should be found to the 'equity issue'. However, a general allocation would also not necessarily resolve inequities among members.

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### The Fourth Amendment

In September 1997 the IMF Board of Governors adopted a resolution for a *Fourth Amendment to the Articles of Agreement* to address the 'equity issue'.[14] The amendment would replace an existing declaratory section of Article XV and insert a new 'Schedule M'.

Schedule M provides the authority and machinery to make a special one-off allocation of SDR 21.4 billion to raise the allocations/quotas ratio to a benchmark of 29.32 percent, based on the quota position of members as at 19 September 1999 (and to double the amount of SDRs previously allocated in 1970-1972 and 1978-1981). It also provides that future members will receive an automatic allocation in an allocations/quotas ratio of 29.32 percent, adjusted for any increases in total quotas or allocations after 19 September 1999. In addition, it provides a dispensation for the incorporation of Serbia/Montenegro and an exception under which allocations to members who have overdue obligations are held in escrow. The *Fourth Amendment* will come into effect when accepted by three fifths of the members, carrying 85 percent of the voting power. Some of the 'winners' and 'losers', in terms of the change in allocations/quotas ratios are listed in the following table.

**Some 'Winners' and 'Losers' from the *Fourth Amendment*[15]**

| *Winners* | | *Losers* | |
|---|---|---|---|
| *Member* | *Ratio Change %* | *Member* | *Ratio Change %* |
| Singapore | **1434.72** | Afghanistan | 32.18 |
| Kuwait | 1413.89 | Haiti | 29.92 |
| Lebanon | 1254.62 | Laos | 21.82 |
| Saudi Arabia | 947.35 | Liberia | -0.50 |
| Korea | 556.83 | Congo | -1.16 |
| China | 480.27 | Sudan | -4.68 |
| Japan | 337.68 | Somalia | **-5.40** |

### The Eleventh General Review of Quotas

Perhaps ironically, in January 1998 the Board of Governors adopted a resolution to increase the total fund quotas from SDR 145.6 bn to SDR 212.0 bn. The resolution was supported by the required majority and the increases became effective on 22 January 1999. Thus, the capacity of members to borrow from the common pool has been increased.

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While this did not resolve inequities among members, it did assist certain members by increasing their ability to benefit from the conditional liquidity facilities of the IMF.

### Quotas v Allocations

To some extent, the quota issue may be more significant than the equity issue since quotas determine members' borrowing rights. As the IMF has acknowledged, an adequate level of quotas 'supports members' efforts at establishing currency convertibility and trade liberalization'. It also 'assists those members making the transition to market-based economies' and provides support to members undertaking 'adjustment programs', ie smaller and emerging economies.[16] Moreover, as the above table illustrates, while the adjustment of allocations assists *all* new members, by giving them unconditional liquidity, and *most* poorer members, by extending their unconditional liquidity, it has provided far greater benefit to members whose economies have grown significantly since the last general allocation than to members whose economies have declined since that time.

## National Interest Analysis

A number of points arise from the National Interest Analysis to the *Fourth Amendment*. In considering the relative costs and benefits, it is noted that Australia would benefit indirectly from the special allocation because it would extend unconditional liquidity of smaller members and 'allow poorer countries to meet part of their reserve needs at a lower cost than otherwise'.[17] In turn, this would ease the demand on international financial institutions for liquidity and the burden on industrialised nations for financial aid.[18] At the same time it is noted that the special allocation to Australia 'would not impact on the Commonwealth's fiscal budget balance', however it would, *in theory*, increase the liabilities of Commonwealth to the IMF 'due to the possible [or hypothetical] future cancellation of SDRs, withdrawal of Australia from the SDR Department, or liquidation of the SDR Department'.[19]

Arguably, the risk of the above events is very slight. While the IMF has the power to cancel SDRs, to date there have been no cancellations. Also, while any member may withdraw from the IMF, there have been no withdrawals to date nor does there appear to be any pressure or incentive for Australia to withdraw. Arguably, there is a case for restructuring the IMF, but there does not appear to be any argument in favour of liquidating the SDR Department or the SDR system.

The restructuring issue was addressed briefly by the Joint Standing Committee of Treaties. *Report 25* discussed an article by Professor John Burnham which argued in favour of a merger between the IMF and the World Bank.[20] To some extent the argument was supported by other critics including the British Government. However, while the proposal envisaged liquidation of the IMF, the emphasis was on conditional rather than unconditional liquidity and it seemed to be accepted that balance of payments support, including the SDR system, would be maintained by the Bank for International Settlements.

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## The Act

Australia joined the IMF in 1947. Its relationship with the IMF is governed by the *International Monetary Agreements Act 1947* (the Act), which sets out Australia's financial commitments to the IMF and the process through which those commitments will be met. The *Articles of Agreement* are contained in Schedule 1 of the Act.

# Main Provisions

Schedule 1 seeks to amend Schedule 1 of the Act to reflect the *Fourth Amendment to the Articles of Agreement*. **Item 1** amends Section 1 of Article XV the *Articles of Agreement* to clarify existing arrangements for general allocations and to require the IMF to make a special allocation in accordance with Schedule M of the *Articles of Agreement*.

**Item 2** inserts Schedule M at the end of the *Articles of Agreement*. As indicated above (under the heading 'Fourth Amendment') Schedule M provides the authority and machinery for the IMF to make a special one-off allocation of SDR 21.4 billion to raise the allocations/quotas ratio to a benchmark of 29.32 percent.

# Endnotes

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1 International Monetary Fund, 'International Monetary Fund: the Role of the IMF and IMF History'.

2 Parliamentary Library, International Monetary Agreements Amendment Bill 1998, *Bills Digest No. 165 1997-98*, 24/3/98.

3 International Monetary Fund, 'IMF at a Glance: A Factsheet', July 2000.

4 Joseph Gold, 'Special Drawing Rights: Character and Use', *Pamphlet Series*, No. 13, 1970, p 8.

5 ibid.

6 ibid, p. 9.

7 See IMF, 'SDR Valuation'.

8 IMF, 'Financial Organization and Operations of the IMF', *Pamphlet Series*, No. 45, 1998, Part V 'SDR Department'.

9 ibid.

10 Source: IMF, 'SDR Allocations and Holdings for all members as of September 30, 2000', October, 2000.

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11 Federated States of Micronesia, Kiribati, Bhutan, Tonga, St. Kitts and Nevis, Antigua and Barbuda, Republic of San Marino, Vanuatu, Belize, Albania, Mongolia, Republic of Estonia, Republic of Tajikistan, Kyrgyz Republic, Republic of Armenia, Mozambique, Republic of Moldova, Republic of Latvia, Namibia, Republic of Lithuania, Brunei Darussalam, Georgia, Azerbaijan, Republic of Uzbekistan, Angola, Slovak Republic, Republic of Kazakhstan, Republic of Belarus, Bulgaria, Czech Republic, Hungary, Republic of Poland, Ukraine, Switzerland, Russian Federation, Marshall Islands, Palau, Eritrea and Turkmenistan.

12 Among those members that have an SDR allocation, the average is around 12.26 percent.

13 Source: IMF, 'SDR Allocations and Holdings', op cit and IMF, 'IMF Members' Quotas and Voting Power, and IMF Governors', November 03, 2000.

14 IMF, Summary Proceedings, 1997.

15 Source: quota data from IMF, 'IMF Members' Quotas, Voting Power, and IMF Governors', op cit, multiplied by 29.32%.

16 IMF, 'IMF Quotas and Quota Reviews: A Factsheet', September 2000.

17 Department of Treasury, Fourth Amendment, done at Hong Kong on 23 September, 1997 of the Articles of Agreement of the International Monetary Fund of 27 December 1945, *National Interest Analysis*, p. 3.

18 ibid.

19 ibid, p. 4.

20 Professor James Burnham, 'The IMF and the World Bank: Time to Merge', *The Washington Quarterly*, Vol. 22(4), Spring 1999, pp 101-111. Professor Burnham is a former U.S. Executive Director at the World Bank (1982-1985).

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