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The IMF's "General Arrangements to Borrow" (GAB): A Background Paper

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Abstract. In the wake of the Mexican financial crisis, the G-7 industrial countries agreed to establish an emergency financing mechanism. This proposal has ultimately evolved into the so-called "New Arrangements to Borrow" (NAB). The NAB, however, parallels and complements the GAB, which were established in 1962. While the proposed NAB would become the facility of first recourse, the GAB remain in existence and are still available to be drawn upon.

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Summary

In the wake of the Mexican financial crisis, the G-7 industrial countries[1] agreed, at the Halifax economic summit of June 15-16, 1995, to establish an "emergency financing mechanism." This proposal has ultimately evolved into the so-called "New Arrangements to Borrow" (NAB).[2] The NAB, however, parallels and complements the GAB, which were established in 1962. While the proposed NAB would become the facility of first recourse, the GAB remain in existence and are still available to be drawn upon. More importantly, the SDR 17.0 billion[3] in existing financial commitments to the GAB are counted as part of the total SDR 34.0 billion in financial commitments that comprise the NAB.

Background

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 issues is the ability of current international financial institutions, most notably the International Monetary Fund (IMF, the Fund), to cope with financial crises generated by the sudden movement of short-term capital or portfolio investment, so-called "speculative" or "hot money."

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[1] The United States, Japan, Germany, France, the United Kingdom, Italy, and Canada.

[2] The NAB are discussed in U.S. Library of Congress. Congressional Research Service. *The IMF's Proposed "New Arrangements to Borrow" (NAB): An Overview*, CRS Report 97-468 E, by Patricia A. Wertman.

[3] The Special Drawing Right (SDR) is an international reserve asset that is created by the IMF and used as its unit of account. The dollar value of the SDR fluctuates on a daily basis.

To deal with the potentially disruptive impact of short-term capital flows, the leaders of the G-7 countries, meeting at the Halifax economic summit on June 15-16, proposed to create an “emergency financing mechanism” by a suggested doubling of the IMF’s General Arrangements to Borrow (GAB). This proposal has ultimately evolved into the so-called “New Arrangements to Borrow” (NAB).

Both the proposed NAB and the already existing GAB are arrangements of medium-term credit lines that are available to the IMF in the event of an international financial crisis. The NAB, however, parallel and complement the GAB, which were established in 1962. Indeed, existing commitments to the GAB are calculated as part of the total SDR 34.0 billion that comprise the NAB. At SDR 17.0 billio, the GAB comprise half of the NAB total. Stated another way, the NAB fulfill the G-7 commitment to double the GAB. Thus, while the proposed NAB would become the facility of first recourse, the GAB remain in effect and may still be drawn upon.

U.S. participation in the NAB requires congressional authorization and appropriation. This report is intended to provide background information on the GAB, the need for which is likely to arise within the context of congressional consideration of the NAB proposal.

GAB Basics: Purpose and Use

The GAB are an arrangement of medium-term credit lines in the amount of SDR 17.0 billion (currently about $23.3 billion).[4] They entitle the IMF to borrow currencies from 11 major industrial countries. These include the G-7 plus Belgium, Netherlands, Sweden, and Switzerland, which became a GAB participant in 1964 and a Fund member in 1992.[5] An SDR 1.5 billion (about $2.2 billion) credit arrangement with Saudi Arabia is also associated with the GAB. It was negotiated in 1983.

The circumstances that led to the currently proposed NAB, in some sense, echo the currency turmoil that led to the creation of GAB. The GAB were set up, after considerable negotiation, in January 1962, by a decision of the Executive Board of the IMF. Following the establishment of external currency convertibility by most European countries in 1958 and by Japan in 1961, most restrictions on short-term capital flows had been lifted. In addition, both the United States and the United Kingdom — the key currency countries in the Bretton Woods system of fixed exchange rates — were experiencing balance-of-payments difficulties. Exchange rates, therefore, were under substantial pressure from short-term, speculative capital flows. The GAB were one of a number of seemingly temporary measures taken to deal with these speculative flows.[6] Today, it is the emerging economies, such as in Latin America and East Asia, that have recently opened up, making themselves vulnerable to sudden shifts in market sentiment.

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[4] At the rate of $1.36928 per SDR as of April 10, 1997.

[5] The original 10 participants in the GAB gave rise to the so-called “Group of 10,” which has in large measure controlled the IMF and international monetary system. The G-7 is, in essence, a rump group of this earlier group.

[6] Another notable measure was the setting up of systematic currency “swap” lines by the Federal Reserve with other central banks. Mexico used its swap line during the 1994-1995 crisis.

Thus, the need to counter disruptive short-term capital flows has reappeared as an issue for policymakers.

Reflecting their history, the GAB are intended to provide the Fund with *supplemental* resources to "forestall or cope with an impairment of the international monetary system."[7] They are emergency resources. They are also a non-quota[8] based financial resource of the Fund. As such, they are fully under control of the participants and not the IMF.

Decisions to activate the GAB are made by the participants upon the call of the Managing Director of the IMF. The GAB are activated in cases of large drawings on the IMF. All GAB drawings have been made by GAB participants. Altogether, the GAB have been activated nine times since their inception in 1962. The United States was the last country to activate the GAB when the Fund borrowed from Japan and Germany to finance a U.S. reserve tranche purchase of SDR 777 million (then about $1.0 billion) in 1978. This was the only time the United States drew on the GAB. By comparison, the United Kingdom drew on the GAB five times between 1964 and 1977, for a total drawing of SDR 3,246 million. France drew on the GAB in 1968 and in 1969, for a total drawing of SDR 640 million. Italy drew SDR 90 million in 1977.

Since the IMF is borrowing from GAB participants, the risks of a failure to repay are borne by the IMF as the financial intermediary. Any impairment of the IMF's financial stability, however, would, ultimately, have to be dealt with by its shareholders, including the United States. Interest is paid to GAB creditors at the SDR interest rate, which fluctuates, reflecting the short-term market rates of its constituent currencies — the U.S. dollar, the German mark, the Japanese yen, the French franc, and the U.K. pound sterling. During the week beginning March 17, 1997, for example, the SDR interest rate stood at 3.98 percent. Interest is accrued daily and paid quarterly. The IMF is required to pay back GAB lenders within 5 years, but may repay earlier. At present, the IMF does not have any borrowings outstanding to the GAB creditors.

The GAB were initially put in place for a 4-year period. They have, however, been repeatedly renewed so that they are, in effect, now nearly permanent. As currently constituted, the GAB are now set to expire on December 25, 1998. Amendments to the GAB require, not only the approval of the IMF Executive Board, but, more importantly, of the GAB participants.

The 1983 Expansion

[7] Preamble, GAB.

[8] Quotas, or members' capital subscriptions, are the basic financial resource of the IMF. They determine borrowing privileges, voting rights, and any distribution of Special Drawing Rights (SDRs).

For more details on the financial structure of the IMF, see U.S. Library of Congress. Congressional Research Service. *The International Monetary Fund: A Short Overview*, CRS Report 97-228 E, by J.F. Hornbeck.

Originally totalling $6.0 billion,[9] the GAB credit lines were somewhat increased by the addition of Switzerland in 1964 and by an increase in Japan's credit line in 1976. In 1983, however, the GAB lines were substantially expanded. Their overall size was increased to the current level of SDR 17.0 billion (about $23.3 billion), from SDR 6.3 billion. In addition, individual credit lines were altered to reflect changes in the relative economic strength of participants. As can be seen from **table 1** on the next page, the U.S. share of the GAB is presently SDR 4,250 million (about $5,819.4 million) or one-quarter of the total.

Until 1983, only the 11 countries participating in the GAB could borrow from them. In the wake of the 1980s Third World debt crisis, however, the GAB were expanded to enable nonparticipating Fund members also to borrow under the GAB. Fund calls upon GAB resources on behalf on nonparticipants must, however, meet stricter criteria than those established for calls on behalf of participants. The circumstances surrounding a call to finance a nonparticipant must meet two key requirements: 1) they must represent a "threat" to, rather than just an "impairment" of, the international monetary system, and 2) the Fund must face an "an inadequacy of resources."[10] This latter condition is not a requirement of the NAB, thereby making the GAB relatively more difficult to draw upon than the NAB. When borrowing from the GAB, nonparticipants are also required to have an IMF economic adjustment program in place. Finally, in deciding to tap GAB resources, the IMF's Managing Director must pay due regard to the potential borrowing needs of GAB participants.

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[9] The SDR was not created until 1969. Prior to that time the share of each participant in the GAB was stated in the U.S. dollar equivalent of the participant's currency rather than in SDRs.

[10] GAB, para. 21 (b).

Table 1. General Arrangements to Borrow (GAB)

Country/Central Bank	Amount in SDRs (Million)	Percentage Share (%)	Approximate Dollar Value (Million)[a]
United States	4,250.0	25.00	$5,819.4
Deutsche Bundesbank	2,380.0	14.00	$3,258.9
Japan	2,125.0	12.50	$2,909.7
France	1,700.0	10.00	$2,327.8
United Kingdom	1,700.0	10.00	$2,327.8
Italy	1,105.0	6.50	$1,513.1
Swiss National Bank	1,020.0	6.00	$1,396.7
Canada	892.5	5.25	$1,222.1
Netherlands	850.0	5.00	$1,163.9
Belgium	595.0	3.50	$814.7
Sveriges Riksbank (Sweden)	382.5	2.25	$523.7
TOTAL	**17,000.0**	**100.00**	**$23,277.8**

[a] Calculated at the rate of $1.36928 per SDR, as of April 10, 1997.
Source: CRS, from International Monetary Fund information.

Budgetary Treatment

Historically, funds to enable U.S. participation in the establishment of the GAB in 1962 and in their expansion in 1983 were appropriated. In practice, funds provided to the IMF under the GAB are provided upon call, that is, notification by the Fund to a participant to make a transfer to the Fund's account under its GAB credit lines. A budget expenditure occurs, therefore, only as cash is actually transferred to the IMF. If a transfer is made, the United States receives an equal, offsetting asset — its loan to the IMF. In budgetary terms, such offsetting transactions are treated as an exchange of assets. As a consequence, they do not result in net budget outlays, and they do not increase the federal budget deficit.