The Global Financial Crisis: Increasing IMF Resources and the Role of Congress

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Summary

At their meeting in London on April 2, 2009, the leaders of the 20 systemically important industrialized and developing countries (G-20) agreed on several initiatives to bolster the International Monetary Fund's (IMF) resources, improving its ability to provide financial assistance to countries impacted by the ongoing financial crisis. These included increasing the resources of the IMF and international development banks by $1.1 trillion including $750 billion more for the IMF, $250 billion to boost global trade, and $100 billion for multilateral development banks. For the additional IMF resources, $250 billion was to be made available immediately through bilateral arrangements between the IMF and individual countries, while an additional $250 billion would become available as additional countries pledged their participation.

On May 12, 2009, the White House formally requested that Congress consider increasing the U.S. contribution to the IMF based on commitments made by the Bush Administration in 2008 and by the Obama Administration at the London meeting of the G-20 countries in April 2009. At the meeting, G-20 leaders agreed that the IMF's New Arrangements to Borrow (NAB), a supplemental fund to bolster IMF resources, should be increased by up to $500 billion from its present level of $50 billion ("Global plan for recovery and reform: the Communiqué from the London Summit," April 2, 2009, available at http://www.londonsummit.gov.uk/en/summit-aims/summit-communique/). The Obama Administration proposed that the United States contribute up to $100 billion. The G-20 also agreed that the IMF should create $250 billion in new Special Drawing Rights (SDR) and allocate them to its members through its SDR Department.

Already pending at the time of the G-20 meeting was a proposal for a new increase in IMF quota resources. Negotiations on a package of reforms and a new quota increase were completed in April 2008, and the proposals were submitted to the House and Senate by the Bush Administration in November 2008. The U.S. share is about $8 billion. The package includes reform of IMF governance, finances, and procedures. It also includes a proposal that the IMF sell 403 metric tons of gold to create a facility that would cover the costs of its country and global surveillance, technical assistance, research, and other non-lending operations.

U.S. participation in the new IMF quota increase and a U.S. subscription of $100 billion for the NAB required congressional approval. Likewise, amendments to the IMF Articles—including the prospective Fourth Amendment for a new SDR allocation—required congressional approval. On the other hand, the proposed $250 billion allocation of SDRs (which is being made under a different provision of the IMF Articles) was too small to trigger the legal requirement that Congress give its assent. Any contributions to the IMF, to fund increases in the U.S. quota or to subscribe new resources to the NAB, must be authorized by Congress.

Despite concerns about the process of authorizing and appropriating contributions to the IMF, and the impact on the global economy of creating a large of amount of SDRs, U.S. participation in the funding agreement, and the requisite authorizations for IMF reform efforts, were included in the FY2009 Spring Supplemental Appropriations for Overseas Contingency Operations (P.L. 111-32).

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On May 12, 2009, the Obama Administration formally requested that Congress consider increasing the U.S. contribution to the International Monetary Fund (IMF) based on commitments made by the Bush Administration in 2008 and by the Obama Administration at the London meeting of the G-20 countries in April 2009.[1] At the meeting, G-20 leaders agreed that the IMF's New Arrangements to Borrow (NAB), a supplemental fund to bolster IMF resources, should be increased by up to $500 billion from its then current level of $50 billion.[2] The Obama Administration proposed that the United States contribute up to $100 billion. Pledges totaling $411.5 billion have since been received from several countries.[3] The G-20 also agreed that the IMF should create $250 billion in new Special Drawing Rights (SDR) and allocate them to its members through its SDR Department. These new resources would expand world foreign exchange reserves by about 4%.

Already pending at the time of the G-20 meeting was an IMF reform package comprising a modest quota increase to boost the relative share of underrepresented developing countries and several governance reforms. The U.S. share of the quota increase is around $8 billion, the amount required to maintain the existing 16.77% U.S. voting share, which provides a veto on major IMF decisions requiring an 85% majority. The reform package also included a proposal to sell 403 metric tons of gold held by the IMF to create an income-generating fund to partially finance the IMF's country and global surveillance, technical assistance, research, and other non-lending operations.[4]

U.S. participation in the funding agreement, and the requisite authorizations for IMF reform efforts, were included in the FY2009 Spring Supplemental Appropriations for Overseas Contingency Operations (P.L. 111-32). This report provides information on (1) the role the IMF has played in the financial crisis, (2) international agreement to increase the financial resources of the IMF, and (3) the role of Congress in increasing the Fund's resources.

The Financial Crisis and Developing Countries[5]

What began as a bursting of the U.S. housing market bubble and a rise in foreclosures has ballooned into a global financial and economic crisis. The crisis has exposed fundamental weaknesses in financial systems worldwide. Despite coordinated easing of monetary policy and trillions of dollars in intervention by central banks and governments, economies continue to

[1] For background on the IMF, see: "Financial Organization and Operations of the IMF," *International Monetary Fund*, 2001. The document is available at: http://www.imf.org/external/pubs/ft/pam/pam45/contents.htm.

[2] "Global plan for recovery and reform: the Communiqué from the London Summit," April 2, 2009. The communiqué is available at: http://www.londonsummit.gov.uk/en/summit-aims/summit-communique/.

[3] They include: Japan - $100 billion; European Union - $100 billion; Norway - $4.5 billion; Canada - $10 billion; Switzerland - $10 billion; Korea - at least $10 billion; Australia - $7 billion; Russia - up to $10 billion; China - up to $50 billion, and Brazil - up to $10 billion. "Bolstering the IMF's Lending Capacity," *International Monetary Fund*, July 8, 2009. Webpage is available at: http://www.imf.org/external/np/exr/faq/contribution.htm.

[4] Edwin M. Truman, "On What Terms is the IMF Worth Funding," *Peterson Institute for International Economics*, December 2008. The working paper is available at: http://www.piie.com/publications/wp/wp08-11.pdf.

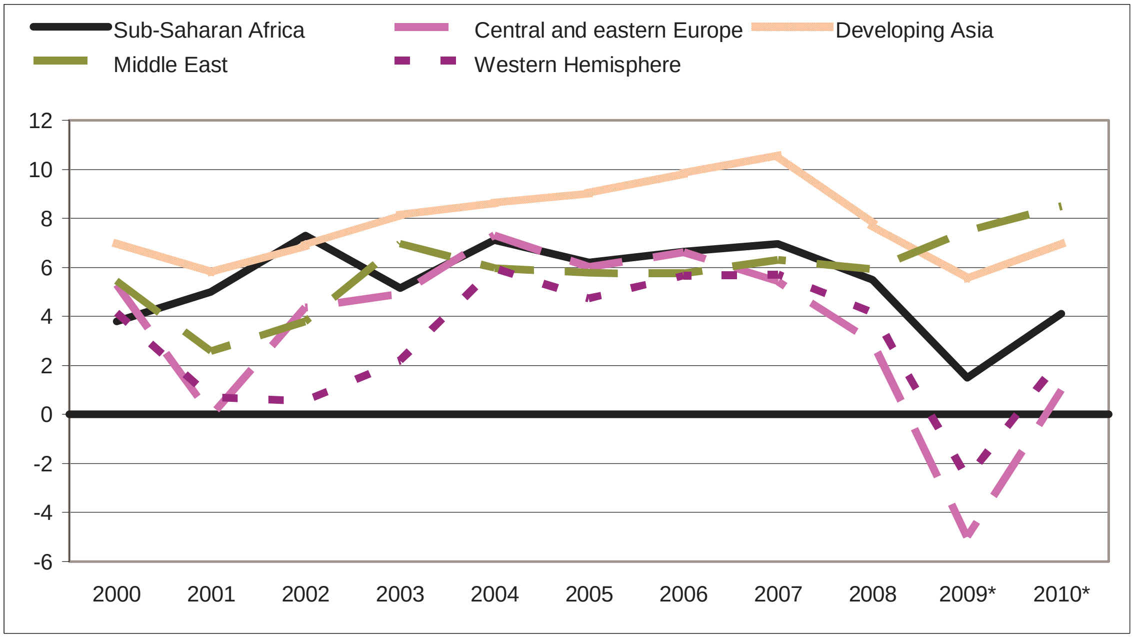
[5] CRS Report RL34742, *The Global Financial Crisis: Analysis and Policy Implications*, coordinated by Dick K. Nanto.

decline into what is turning out to be the most severe global recession since the Great Depression of the 1930s.

On April 22, 2009, coinciding with the London G-20 meeting, the IMF forecasted economic growth of -1.3% for 2009—the lowest since World War II. Lower global growth, weak demand for exports, a precipitous drop in commodity prices, and increased risk aversion in the developed markets have all contributed to weak economic growth in developing countries (**Figure 1**). Central and Eastern Europe and Latin America have been particularly hard-hit.

Figure 1. Impact of the Crisis on Developing Regions

Annual GDP Growth Rate

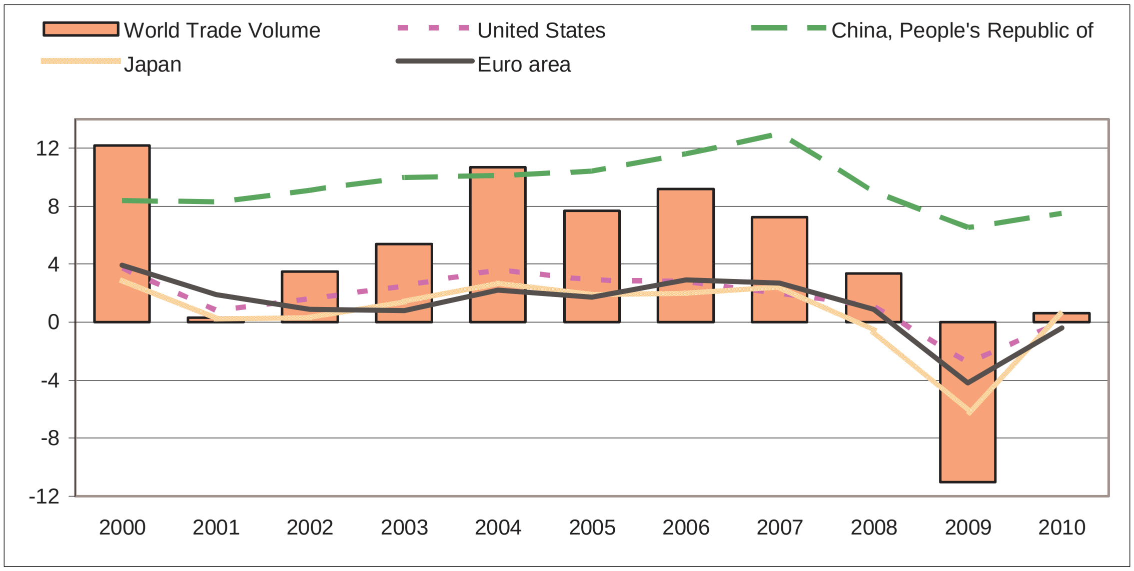


Source: IMF World Economic Outlook Database, estimates as of July 2009.

The crisis is impacting developing countries through several channels. First, economic slowdown in the advanced economies is leading to decreased demand for developing country exports (**Figure 2**) and a contraction of capital flows (**Figure 3**). Developing countries also suffer from the collapse of commodity prices. Rapid economic growth in China and India over the past decade led to record prices for petroleum, minerals, and other commodities. Between 2003 and 2008, oil prices rose by 320% and food prices by 138%. Since mid-2008, however, weakening demand for these exports has led to a rapid decline in the price of many of these commodities. The combination of declining foreign direct investment, portfolio investment, weak export demand, and a more constrained environment for remittances and foreign aid, has put pressure on many country's government fiscal balances (**Figure 4**).

Figure 2. GDP Growth in Major Export Markets and World Trade

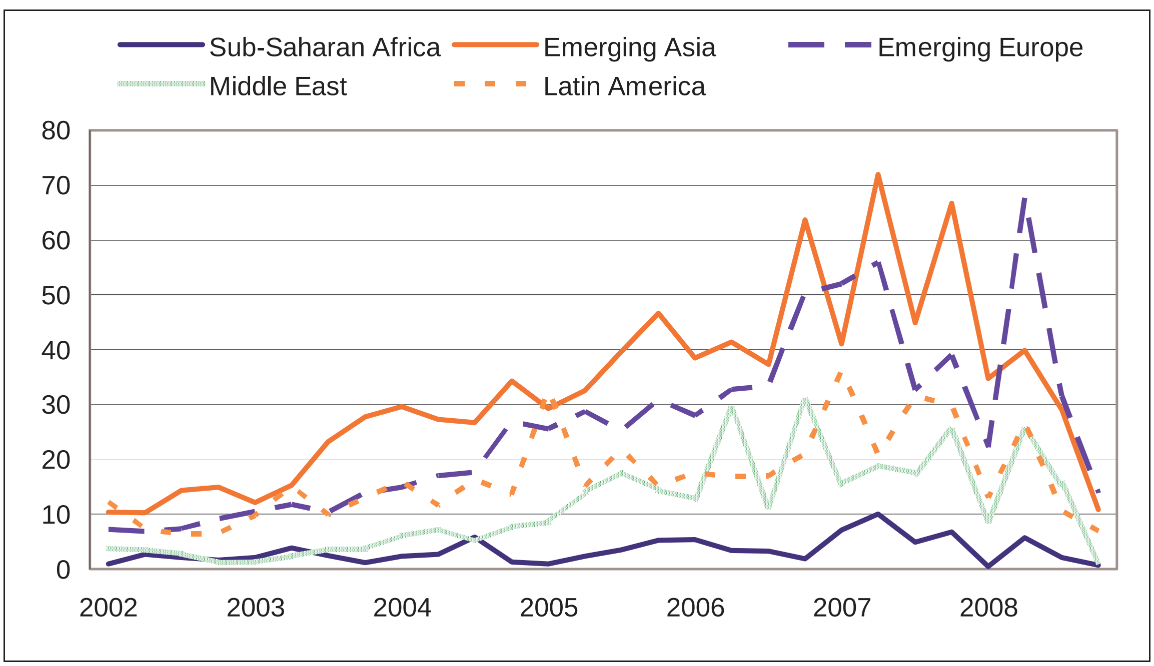
Annual Percentage Change



Source: International Monetary Fund

Figure 3. Private Capital Flows

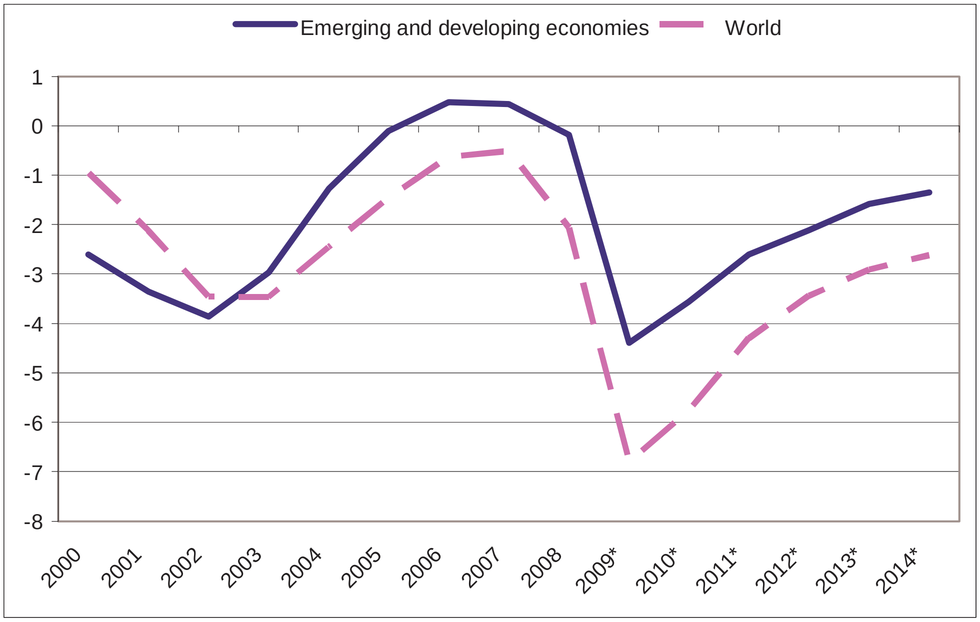
Bond, equity, and loan issuances ($ billion)



Source: International Monetary Fund

Figure 4. General Government Fiscal Balances

Percent of GDP



Impact of the Crisis on the IMF

The severity of the current financial crisis presented a challenge for the IMF, whose financial resources had not kept pace with the global economy over the past decade. The IMF reported in early 2009 that its resources would need to grow by 55% to match the level of its resources (relative to global output) that it held during the Asian financial crisis of 1997-1998.

Demand for IMF resources in late 2008-2009 has been strong. Between October and December 2008, lending almost doubled, from $17.1 billion to $32.54 billion. As of July 2009, IMF lending commitments are $157 billion, a record high.[6] The recent rise in IMF lending, however, was preceded by historic lows. On August 31, 2008, total IMF lending was $16.65 billion, down from a peak of $116 billion in September 2003.[7] Since the IMF's main source of income is the interest paid on its loans, weak demand for IMF loans between 2000 and 2008 resulted in shortfalls in the IMF's administrative budget and a roughly 20% reduction in IMF staff during 2007-2008.

Given the IMF's constrained financial situation, many analysts raised concerns that the institution did not have the necessary resources should there be widespread demand for IMF financial support. Total IMF quota, $337.2. billion (as of July 2009) is small compared to the growth of capital flows to emerging economies, let alone the advanced economies.

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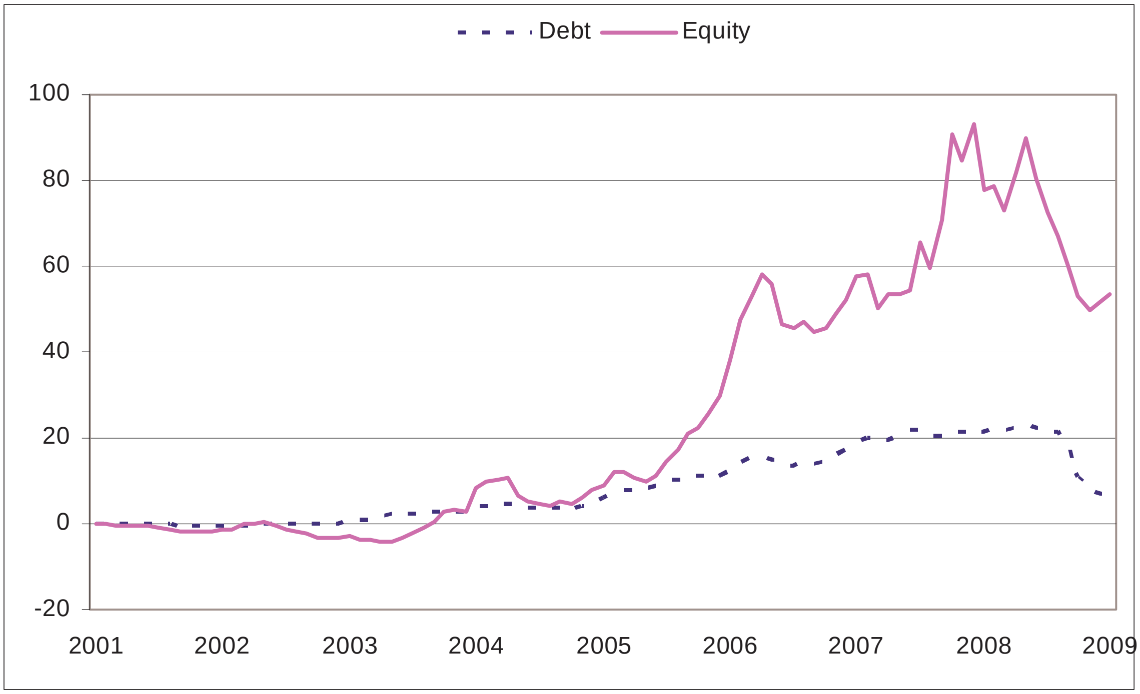
[6] "A Changing IMF—Responding to the Crisis," *International Monetary Fund*, July 2009. Factsheet is available at: http://www.imf.org/external/np/exr/facts/changing.htm.

[7] Total IMF Credit Outstanding for all members from 1984-2008, available at: http://www.imf.org/external/np/fin/tad/extcred1.aspx.

Figure 5. Capital Flows to Emerging Economies

Billions of U.S. Dollars



Source: International Monetary Fund

If the G-20 pledges of $500 billion in new resources are realized, many argue that the IMF will once again have the financial resources to credibly lend to developing countries impacted by the crisis.

Increasing Fund Resources

New Arrangements to Borrow (NAB)

The NAB are a set of credit arrangements, created in 1998, between the IMF and 26 developed country members and institutions to provide supplementary resources that the IMF can use to help financial crises in countries of major significance to the world financial system.[8] The NAB was activated once, in December 1998, to finance a loan for Brazil.

At the G-20 meeting in April 2009, the major countries agreed that the resources of the NAB should be expanded by about $500 billion. The G-20 agreed that $250 billion should be made available immediately to the IMF through bilateral arrangements between the IMF and individual countries. The G-20 also agreed that the NAB would be expanded by an additional $250 billion

[8] An earlier facility, the General Arrangement to Borrow, was created for a similar purpose in 1962.

as more countries pledged their participation. To date, pledges totaling $411.5 billion have been received from several countries.[9]

The NAB are supplemental, emergency mechanisms. They 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. If activated, participating donor countries make loans to the IMF, and the IMF uses those funds to provide loans to eligible countries. Repayments flow from the country to the IMF and then from the IMF to the NAB.

Under current NAB rules, before the IMF can draw against NAB resources, an 85% majority of the IMF Executive Board and countries representing 80% share of the NAB credit volume must agree. The IMF must repay the NAB creditors within five years.

SDR Allocation

As noted above, G-20 leaders agreed in April that the IMF create $250 billion worth of new SDRs and allocate them to its member countries. SDRs are created and allocated solely by the IMF. Separately, the Obama Administration requested that Congress approve an amendment to the IMF Articles of Agreement, originally proposed in 1997, that would permit a special allocation of SDRs to IMF member countries that joined the IMF following the initial allocation. None of the funds being contributed by the United States or other countries to expand the NAB will be used to fund the new allocation of SDRs.

The First Amendment to the IMF Articles, which went into effect in 1969, authorized the IMF to create a new international reserve asset that could be used to supplement its member country's foreign exchange reserves. This asset, known as special drawing rights (SDRs), is neither a currency, nor a claim on the IMF. Rather, it is a potential claim on the freely usable currencies of IMF members. SDRs are created by fiat, and are not "paid for" by any foreign contributions or backed by any national currency.

SDRs are not a global reserve currency. However, they may be exchanged for hard convertible currency among IMF member nations. Established rules govern how a country may exercise its claim and convert its share of SDRs into another country's hard currency. The SDR serves as the IMF's standard unit of account.[10]

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[9] They include: Japan - $100 billion; European Union - $100 billion; Norway - $4.5 billion; Canada - $10 billion; Switzerland - $10 billion; Korea - at least $10 billion; Australia - $7 billion; Russia - up to $10 billion; China - up to $50 billion, and Brazil - up to $10 billion. "Bolstering the IMF's Lending Capacity," *International Monetary Fund*, July 8, 2009. Webpage is available at: http://www.imf.org/external/np/exr/faq/contribution.htm.

[10] The currency value of the SDR is determined by summing the values in U.S. dollars, based on market exchange rates, of a basket of major currencies (the U.S. dollar, euro, Japanese yen, and pound sterling). The SDR currency value is calculated daily and the valuation basket is reviewed and adjusted every five years. For example, on August 4, 2009, $1.00 equaled SDR 0.637. "Exchange Rate Archives by Month," *International Monetary Fund*, accessed August 5, 2009. The Webpage is located at: http://www.imf.org/external/np/fin/data/param_rms_mth.aspx.

IMF Bond Sales

Several developing countries with considerable foreign exchange reserve holdings have been approached about contributing to the G-20 pledge to increase IMF resources. Many have expressed their unwillingness to lend money to the institution until broader governance reform at the institution is achieved. While some changes in quota share were agreed to at the April 2008 IMF spring meetings that will increase developing country representation, they have been widely characterized as modest. Many developing countries have thus sought a temporary means to provide assistance to the IMF, while delaying a more permanent contribution until more substantial governance reforms give them a larger representation in the institution.[11] For countries with large reserves, these bonds are attractive since they provide an additional vehicle for diversifying the currency composition of their foreign exchange reserves. (Most foreign exchange reserves are currently held in only a few currencies including U.S. dollars, euros, and Japanese yen.)

Article 7 of the IMF's Articles of Agreement provides the IMF the authority to issue bonds. Neither U.S. Treasury consent, nor congressional authorization, is needed. The IMF has never issued bonds in its 60-year history; however, on July 1, 2009, the IMF approved a framework for issuing bonds to member countries and their central banks.[12] These bonds would be sold only to member countries, who may trade them only among themselves. Countries would not be allowed to sell the bonds to private firms or individuals on the secondary market. Several members have already expressed their interest in buying IMF bonds, with China signaling its intention to invest up to US$50 billion, and Brazil and Russia up to US$10 billion each.[13] The notes have a maximum maturity of five years and will be denominated in SDRs.

The implication for the United States of the proposal would be mixed. If successful, the proposal could lead to greater international macroeconomic security. One concern, however, about the bond sales is that if increasing amounts of foreign exchange reserves are transferred out of dollars into IMF bonds, the future demand for U.S. Treasury bills and agency instruments (traditional reserve instruments) may decline, thus increasing the yield on low-risk assets. This would raise the cost to the United States of future debt placements and possibly accentuate a trend of countries slowly diversifying their reserves out of the dollar. Many analysts have argued that since the Asian financial crisis (and during the current crisis), foreign demand for U.S. Treasury assets (largely from central banks) has played a crucial role in depressing U.S. interest rates. Should demand for U.S. Treasury assets decrease because of asset allocation decisions by foreign central banks, or because foreign governments need to spend more of the reserves domestically and have less to invest, there could be upward pressure on U.S. interest rates. However, the overall demand for U.S. Treasury bonds may also be minimally impacted if they are held instead by an emerging market country that receives IMF loans rather than by an emerging market country purchasing IMF bonds.

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[11] For background, see: CRS Report RL33626, *International Monetary Fund: Reforming Country Representation*, by Martin A. Weiss.

[12] "IMF Approves Framework for Issuing Notes to the Official Sector," *International Monetary Fund*, July 1, 2009. Press Release is available at: http://www.imf.org/external/np/sec/pr/2009/pr09248.htm.

[13] Ibid.

IMF Governance Reforms

Several IMF proposals were already pending at the time of the G-20 meeting on April 2, 2009. These proposals are part of an IMF governance reform package negotiated between 2006 and 2008. The George W. Bush Administration submitted proposed legislation regarding these reforms in November 2008, but it was not taken up by the 110th Congress. The reforms included plans for a an increase in IMF quotas for selected members and several procedural, policy, and financial reforms.

The quota increase involved a targeted realignment in the voting shares of member countries in order to give poor countries and dynamic emerging market countries more say in the organization. The U.S. voting share in the IMF would remain at its present 16.77% and the United States would retain the capacity to block the 85% vote that is required to approve most major initiatives in the Fund. Under this reform of IMF quotas, 54 under-represented countries would see their combined quota share in the Fund increase by about 5% of the total.

Other reforms included in the governance reform package include: (1) a new formula for determining country quotas, giving much more weight to GDP and thus better reflecting countries' weight in the world economy; (2) a tripling of "basic votes"—equally allocated votes—thus giving the poor countries an increased voice in the organization; (3) an additional Alternate Executive Director for the two constituencies of the Executive Board representing countries in sub-Saharan Africa; and (4) changes in the IMF's investment and financial procedures, including the sale of gold to finance the establishment of an income-generating endowment fund to help pay for the IMF's activities (research, policy and technical assistance, etc.) that are not related to its loan operations. Those reforms requiring congressional action, were authorized in the FY2009 Spring Supplemental Appropriations for Overseas Contingency Operations (P.L. 111-32), signed by President Obama on June 24, 2009.

Congressional Action

Some of the provisions discussed above required congressional assent and some did not. Congressional action is required before the United States can vote for amendments to the IMF Articles, for gold sales, or for quota increases that involve contributions by the United States.

Congress and the New Allocations of SDRs

As noted above, G-20 leaders agreed that IMF create $250 billion worth of new SDRs and allocate them to its member countries. Separately, the Obama Administration requested that Congress approve an amendment to the IMF Articles of Agreement, originally proposed in 1997, that would permit a special allocation of SDRs (around $32 billion) to IMF member countries that joined the IMF following the initial allocation.

U.S. contributions to the IMF, either for the $8 billion increase in the U.S. quota or the $100 billion increase in the U.S. line of credit to the NAB facility, are not linked to the forthcoming allocation of $250 billion worth of SDRs. No funds provided by the United States are being used to facilitate the new allocation of Special Drawing Rights (SDRs).

New Allocation of $250 billion of SDRs

If an 85% majority of the IMF membership agrees, the IMF can unilaterally create new SDRs and allocate them to its member countries. Article XXVIII of the Fund's Articles of Agreement specifies the procedure that is to be used. The SDR Department handles these operations. The resources of the SDR Department and the IMF's General Reserve are not co-mingled, and the two accounts have different rules. (The IMF uses the resources of its General Reserve to fund its loans to borrower countries.) SDRs held in the SDR Department belong to the countries holding them and not to the IMF. Countries may use these SDRs to settle accounts with other IMF member countries, or they may transfer ownership to other countries in exchange for an equivalent value of the purchaser country's currency. The IMF serves as broker for these exchanges. Through the IMF, countries pay or receive interest when they sell or buy each other's SDRs.

No congressional action is needed for this allocation to take effect. In the Special Drawing Rights Act of 1968, Congress gave the Administration authority to vote for the First Amendment to the IMF's Articles of Agreement creating the SDR, and set forth the guidelines for U.S. participation in the SDR Department. Section 6 of the Act says that Congress must give its consent before the United States can vote for any allocation of SDRs that would be equal to or greater than the existing U.S. quota in the IMF. However, the Act also says that if the U.S. share of a new allocation of SDRs is less than the size of the U.S. quota, the United States can support an SDR allocation as long as the Treasury Department consults with leaders of the House and Senate authorizing committees at least 90 days in prior to the vote. The 90-day period began on April 13, 2009, when a Treasury official notified Congress that the United States planned to vote in favor of the proposed new allocation of SDRs.

Special SDR Allocation for New IMF Members

Separately, a proposal was been pending since 1997 to grant SDRs to countries that joined the IMF since the IMF's last designation of SDRs in 1979-81. When a country joins the IMF, they do not automatically receive a share of SDRs since any increase of IMF SDRs that is not proportional for all members requires an amendment to the IMF's Articles of Agreement. Currently, over 1/5th of the IMF's membership is ineligible to participate in the SDR Department.

Since this allocation is not equi-proportional (all countries receiving a share equal to their quota share), it requires an Amendment to the IMF's charter, what has come to be known as the "Fourth Amendment." To be enacted, the Fourth Amendment (or any IMF amendment) requires an affirmative vote of three fifths of the IMF membership with 85% of the total voting power. Prior to passage of the FY2009 Spring Supplemental Appropriations for Overseas Contingency Operations (P.L. 111-32), the United States had not voted to accept the amendment. Approval by the United States in the legislation, with a 16.77% voting share, put the Fourth Amendment into effect.

SDRs and Inflation

Some Members of Congress have questioned whether the SDR increase will have an impact on global inflation.[14] The impact of the SDR allocation on global inflation is expected to be modest for several reasons. First, SDRs represent a small percentage of the amount of global foreign reserves. Currently, total SDRs allocated by the IMF are worth approximately $33.5 billion or 0.51% of total foreign exchange reserves of $6.5 trillion as of the first quarter of 2009.[15] An increase of SDRs worth $250 billion would increase the ratio of SDRs to total foreign reserves to 4.3% of total foreign reserves, still a relatively small percentage. The $250 billion increase in potential spending power would be almost indistinguishable compared to the size of the world economy or the value of world trade.

Second, the SDR increase is small compared to other injections of liquidity in the global economy taken by global central banks. Since the beginning of the crisis, the United States, European countries, China and others have injected or are injecting much more spending power into their economies than the IMF will be creating through this new allocation of SDRs. Stimulus measures for the G-20 countries are expected to total 2% of global GDP in 2009 and 1.5% of global GDP in 2010.[16] These measures are likely to have significantly greater inflationary impact than the SDR increase.

Third, the IMF's SDR allocation is to be distributed proportionally among all the IMF member nations, thus muting any inflationary impact it might have. Furthermore, the impact of the global economic crisis on the output of goods and services is expected to linger for several years. However, any additional spending due to an immediate encashment of a country's SDR allocation would likely occur now, rather than in the future. (Otherwise, there would be no need to exchange their SDRs for hard currency.) It is expected that by the time the global economy fully recovers, any potential inflationary pressure from increased spending resulting from the encashment of SDRs will have subsided.

Fourth, since the $250 billion SDR increase is distributed according to countries' quotas, the majority of it will be allocated to advanced economies, which are unlikely to ever use their SDRs.[17] Advanced economies such as the United States, Japan, and the Eurozone countries will

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[14] There is an active and ongoing debate among economists over what causes inflation that is beyond the scope of this report. The assertion that an increase in SDRs will lead to inflation derives from one school of thought, *monetarism*, which posits a strong link between an increase in the global money supply (such as an increase in the total amount of SDRs, which count toward a country's foreign reserve levels) and the level of prices. For more information, see: CRS Report RL30344, *Inflation: Causes, Costs, and Current Status*, by Marc Labonte.

[15] "Currency Composition of Official Foreign Exchange Reserves (COFER)" *International Monetary Fund*, June 30, 2009. Available at: http://www.imf.org/external/np/sta/cofer/eng/cofer.pdf.

[16] World Economic Outlook: Crisis and Recovery, *International Monetary Fund*, April, 2009. Available at: http://www.imf.org/external/pubs/ft/weo/2009/01/pdf/text.pdf.

[17] While this may beg the question why the SDR increase is necessary in the first place, for emerging and least-developed countries, the SDR allocation will provide a significant increase in their foreign reserves, may help remove immediate funding pressures, and may help prevent extensive foreign reserve accumulation, which contributed to global imbalances over the past several years. "Allocation of Special Drawing Rights for the Ninth Basic Period: Draft Executive Board Decision and Managing Director Report to the Board of Governors," *International Monetary Fund*, July 16, 2009. The Decision and Report are available at: http://www.imf.org/external/np/pp/eng/2009/071609.pdf.

receive the majority of the SDRs.[18] These countries could buy and sell SDRs among themselves in order to get useable foreign exchange, but they can do this already—and much more easily—through central bank swaps and other such devices. Lastly, it is unlikely that the United States would sell its SDRs to emerging market countries, partly because it cannot use their currencies to settle obligations to third countries. Moreover, it is unlikely that developing countries willingly purchase U.S. SDRs, since their interest is in selling their SDRs for U.S. dollars and not acquiring additional SDRs.

Gold Sales

Another major component of President Obama's request was for congressional authorization for the Administration to vote in favor of selling 403 metric tons of IMF gold for the purpose of increasing the Fund's liquid reserves. Income earned on these reserves, in turn, would finance a portion of the IMF budget related to its provision of global public goods, such as economic and financial surveillance. The gold sales to benefit poor countries, announced by the G-20 leaders, would be included in this agreed total, as it is expected that the currently high price of gold may provide some additional income beyond what is expected for budget financing. However, any additional income would likely be modest since the current price of gold (around $946 per ounce) is not significantly different from the assumption on which the new income model was based ($850 per ounce). The IMF Articles of Agreement specify that any sale of IMF gold must receive an 85% affirmative vote by the member countries.

Under Article V, Sec. 12 of the IMF's Articles of Agreement, approval of gold sales by the IMF requires an 85% IMF voting majority. The United States has almost a 16.77% vote and could thus block any sale of IMF gold. Understanding this "virtual" veto, Congress, in 1999, enacted legislation in the FY 2000 Consolidated Appropriations Act that authorized the United States to vote at the IMF in favor of a limited sale of IMF gold to fund the IMF's participation in the multilateral Debt Relief Initiative for Heavily Indebted Poor Countries (HIPC).[19] The act amending section 5 of the Bretton Woods Agreements Act (22 U.S.C. 286c), requires the explicit consent of Congress before the executive branch can support future gold sales. However, the law provides that the United States may support the sale of IMF gold without congressional action if the Secretary of the Treasury certifies to Congress that the sale of gold is necessary for the Fund to restitute gold to its members, or to provide liquidity that will enable the Fund to meet member countries' claims on it or to meet threats to the systemic stability of the international financial system.[20]

IMF Quota and NAB Contributions

When the Obama Administration initially requested that Congress approve increasing U.S. contributions to the IMF by $108 billion following the April 2009 G-20 Summit, it did not

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[18] The *Eurozone*, or *Euro Area*, consists of the European Union member state that have adopted the Euro is their currency. To date, 16 countries have adopted the Euro as their sole legal tender: Austria, Belgium, Cyprus, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia and Spain.

[19] CRS Report RL34644, *Debt Relief for Poor Countries*, by Jonathan E. Sanford and Martin A. Weiss.

[20] P.L. 106-113, Consolidated Appropriations Act, 2000, Sec. 504(d).

request new appropriations to cover the cost of U.S. contributions to the IMF. This strategy contradicted the precedent used since 1980 for budgeting for U.S. contributions to the IMF (**Appendix**).

In 2009, there was concern that the procedural aspects of the budget process may have an impact on congressional consideration of the proposed new U.S. subscriptions to the IMF. The Obama Administration did not follow the immediate precedent and proposed to increase U.S. contributions to the IMF through only an authorization, with no corresponding appropriating legislation. Peter Orszag, director of the Office of Management and Budget (OMB), was quoted in April 2009 as saying that he cannot see "any analytical rationale for why something would score zero as an outlay but then score as something in budget authority."[21] Furthermore, the United States actually profited from its participation in the IMF. The Treasury Department is required by law to report to Congress quarterly the financial cost of U.S. participation in the IMF. The most recent report, current through 2007, was submitted in April 2009.[22] The Department reports that, in 2007, the United States earned a net $68 million from its participation in the SDR Department, and it earned a net $362 million from its transactions with the IMF General Department (which deals with quota accounts.)

Nonetheless, some Members of Congress raised concerns that the exchange of assets approach, which led to no budgetary cost to the United States for its IMF contribution, did not correctly reflect the degree of risk of the IMF defaulting on the U.S. contribution, given the current economic turmoil. Supporters of the increased U.S. contribution were also concerned that reverting to the earlier budget procedures, rather than using the one employed since 1980, would be seen as an effort to change the rules in the face of controversy or a signal that the Obama Administration feared that it may not have the votes to approve the measure through the established process.

After several months of negotiations, on May 12, 2009, the White House and Congress reached an agreement to treat the U.S. subscription to the IMF as a line of credit for budgetary purposes, after which the President made the formal request to include authorization and appropriations for the IMF in the FY2010 defense supplemental request. Reminiscent of the method used for the 1966 quota increase, Congress was asked by the Administration to authorize the United States to extend a line of credit for the U.S. contributions to the IMF, which total $108 billion. Unlike IMF quota increases since 1967, the U.S. contribution would be scored as a loan for budgetary purposes under the existing credit reform legislation with a commensurate budgetary impact.

The Federal Credit Reform Act of 1992 (P.L. 101-508) provides that when the U.S. Government makes a loan, it does not need to include the full face value of the loan in the federal budget. Rather, Congress must appropriate, as a potential loan loss reserve, an amount equal to the amount the U.S. Government might lose from these loans as a consequence of defaults. This procedure is used throughout the Federal budgeting process.

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[21] David Rogers, "How to spend without 'spending,'" *Politico*, April 22, 2009. The article is available at: http://dyn.politico.com/printstory.cfm?uuid=D05A3346-18FE-70B2-A8BC4C0B6AC3D747.

[22] [Department of the Treasury.] *Report to Congress on Financial Implications of U.S. Participation in the International Monetary Fund.* Available at: http://www.ustreas.gov/press/releases/reports/imfreportq1q42007.pdf.

CBO is responsible for determining what the prospective loan loss rate might be for any federal loan program. When there are several alternative calculations of the probability of loss, CBO typically uses a average of the possibilities as the figure used to estimate potential loss. This is what CBO did when it determined that the loan loss risk from these payments to the IMF was $5 billion.[23] In the law authorizing U.S. participation in the new IMF funding plans, the FY2009 Spring Supplemental Appropriations for Overseas Contingency Operations (P.L. 111-32), Congress subsequently appropriated $5 billion as a loan loss reserve to cover the risk associated with the new U.S. payments to the IMF.

[23] "Budget Implications of U.S. Contributions to the International Monetary Fund," *Congressional Budget Office Director's Blog*, May 19, 2009, from http://cboblog.cbo.gov/?p=270.

Appendix. Past Budgetary Treatment of U.S. Contributions

In the past 60 years, Congress has handled the bookkeeping aspects for U.S. participation in the IMF in a variety of ways. This system was the result of a compromise among the leading figures on the relevant congressional committees in 1980.

Payments to the IMF were considered to be an exchange of assets because the United States receives back from the IMF a monetary instrument of equal value which it adds to its foreign exchange reserves. The United States receives an increased holding of SDRs in the Fund's SDR Department whenever it purchases SDRs from another country, and an increased reserve tranch position whenever the IMF draws on the U.S. quota to finance loans to borrower countries. Both the SDR and reserve tranche positions are liquid interest bearing assets. SDRs cannot be used to make purchases in the marketplace, but they can be exchanged with other IMF members for currencies or used to satisfy international obligations which in most cases involve the Fund. In the case of loans through the NAB, the United States receives a promissory note from the IMF pledging to repay the loan with interest at a certain time. Credits provided to the IMF through the NAB are considered to be monetary assets and are included in countries' foreign exchange reserves. The proceeds are considered to be readily available because NAB participants can obtain immediate early repayment from the IMF if they have a balance of payments need.

The United States has used various methods over the years to account for the cost of its participation in the IMF. Before 1967, the United States funded its participation in the IMF through a variety of procedures, including public debt transactions and payments from the Exchange Stabilization Fund. In the 1966 quota increase, the U.S. payment took the form of a letter of credit to the IMF which, for technical reasons, the United States mostly borrowed back during the following years.

In 1967, the U.S. Government adopted a unified Federal budget that consolidated the operating budget of the government with other previously off-budget accounts. This was intended to improve clarity and to enhance the government's management of fiscal policy. In the process, the President's Commission on Budget Concepts (PCBC) also examined the procedures by which the United States managed its payments to the IMF. It recommended that payments to the IMF should be treated as monetary exchanges akin to bank withdrawals and deposits rather than as international lending operations. As such, these payments would be handled as an exchange of assets and would be excluded from budget receipts and expenditures. Congress would be asked to authorize new U.S. payments to the IMF, but the cost of those payments would not be included in the Federal budget.

The new budget concept was not fully implemented when the next quota increase was considered by Congress. In addition to legislation authorizing U.S. participation, the Nixon Administration sought and Congress approved appropriations to effect U.S. participation in the plan. They agreed, however, that the exchange of assets concept was sufficient to cover the resulting payments, and they would have no net outlay impact on the U.S. budget.[24] In 1976, when the following quota increase was considered, the Ford Administration proposed and Congress agreed that the transaction would be treated solely as an exchange of assets. Legislation was enacted authorizing U.S. participation in the plan, but no appropriations were required. The same procedure was used the following year to approve a loan by the United States to the IMF's Supplemental Financing Facility ("Witteveen Facility").[25] CBO found, in a study of the budgetary scorekeeping issue in 1978, that any procedure – appropriated, exchanged, on-budget, off-budget – is intrinsically arbitrary and not consistent with similar or comparable programs that are treated differently from a scorekeeping perspective elsewhere in the U.S. budget process.[26]

Many Members of Congress, reportedly, were not happy with this arrangement. Some argued, citing the provision of the U.S. Constitution which says that no money shall be drawn from the Treasury except through an appropriation by law, that the funding for U.S. participation in the IMF must be appropriated. Some also said that treating the U.S. payments to the IMF as an off-budget transaction was inconsistent with the principle of budgetary unity which underlay the work of the Presidential budget commission in 1967 and a violation of the prohibition against "backdoor spending" in the Congressional Budget Act of 1974.

The issue came to a head in 1980 during congressional consideration of legislation to approve U.S. participation in a new quota increase for the IMF. A compromise was ultimately agreed to. Under this arrangement, the full amount of the U.S. subscription to the IMF would be appropriated as budget authority.[27] This gave Congress control over the size of the U.S. payments and the amount of contingent liability the United States undertook through its participation in the IMF. However, consistent with the exchange of assets concept, no outlays would be counted and the payments to the IMF would be deemed to have no net impact on the U.S. budget. This procedure remains in effect to this day.

Congress has taken a different approach in its budgetary treatment of the contingent liability associated with U.S. participation in the multilateral development banks (MDBs). The MDBs

[24] P.L. 91-599 and P.L. 91-619, enacted in December 1970, added Sec. 22 to the BWAA and appropriated necessary funds. The Administration had requested that funds for the quota increase be both authorized and appropriated. U.S. Bureau of the Budget. *The Budget of the United States Government, Fiscal Year 1971*, Appendix, p. 105.

[25] P.L. 94-564, enacted in October 1976, added Sec. 25 to the BWAA, saying that "the U.S. Governor of the Bank (*sic)* is authorized to consent to an increase in the quota of the United States in the Fund equivalent to 1,705 million Special Drawing Rights." The next year, P.L. 95-435, enacted in October 1977, added Sec. 28 to the BWAA, saying that "The Secretary of the Treasury is authorized to make resources available as provided in decision 5509-(77/127) of the Fund, in amounts not to exceed the equivalent of 1,450 million Special Drawing Rights." In neither case were appropriations required. See also Treasury Secretary William E. Simon's paper, "The Exchange of Assets Concept," reprinted in U.S. Congress. Committee on Banking, Currency and Housing. Subcommittee on International Trade, Investment and Monetary Policy. *Hearings on H.R. 13955, June 1 and 3, 1976*. USGPO, 1976, p. 31.

[26] Congressional Budget Office. *U.S. Participation in the Witteveen Facility: The Need for a New Source of International Finance*. March 1978. This paper is available at http://www.cbo.gov/ftpdocs/67xx/doc6727/78-CBO-027.pdf.

[27] P.L. 96-389, enacted in October 1980, added Sec. 32 to the BWAA. This says the Secretary of the Treasury "is authorized to consent to an increase in the quota of the United States in the Fund equivalent to 4,202.5 million Special Drawing Rights, limited to such amounts as are appropriated in advance in appropriation Acts." Congress substituted the latter language for the original text, which approved participation in the quota increase "to such extent or in such amounts [as] are provided in appropriation Acts." The latter language would have required action by the appropriations committees but would not have required formal appropriations to effect the U.S. increase in the IMF.

fund their market-rate loan programs with money borrowed in commercial markets. Because they are backed by substantial reserves and by the callable capital subscriptions of their member countries, the banks can sell their bonds and notes at favorable interest rates, and they pass these relatively low rates on to their borrower countries. MDB member countries subscribe some of their purchases of capital stock in callable capital and some (a fixed ratio, now a very small percent of the cost for each share) in paid-in capital. Callable capital is a type of full faith and credit guarantee to the banks' bondholders from their member countries. Most analysts believe that it is very unlikely that one of the MDBs would go bankrupt, exhausting all its resources, and needing to call on the callable capital of its members in order to satisfy its creditors.

Before 1982, Congress appropriated the full amount necessary for the callable portion of U.S. subscriptions to capital stock in the multilateral development banks (MDB). About $12 billion for callable capital had been appropriated by that time, roughly $8 billion for the World Bank and $4 billion for the regional development banks. No outlays were associated with this budget authority and it had no impact on the budget or the budget deficit. During the 1970s, however, cuts were adopted reducing the appropriations for MDB callable capital. The proponents of these cuts often claimed that they were saving the taxpayers and reducing the budget deficit by hundreds of millions of dollars. The cuts in callable capital were not program oriented, since the full paid-in portion of the subscriptions for MDB capital stock was generally appropriated. The resulting mismatch in appropriations had a negative effect on U.S. participation in the banks.

Consequently, in 1981, Congress decided that funds would no longer need to be appropriated for new U.S. subscriptions to callable capital. Instead, as is now the current arrangement, the size of the annual U.S. subscription is regulated through program limitations in appropriations acts.[28] No formal appropriations are required, though appropriations would be required if there ever were to be a call on callable capital. In the case of the IMF, neither the Balanced Budget Act of 1977 nor Sec. 17 of the BWAA require that budget authority must be appropriated to facilitate future increases in the U.S. quota in the IMF or future loans to the IMF through the NAB. The law is silent as to the budgetary procedures that Congress should use on such occasions.

The procedures are different for the IMF and the multilateral banks, but the budgeting issue in both situations is essentially the same. Should the outlay effect of the U.S. commitment to these institutions be counted as zero or is there a likelihood that the IMF will not pay the United States back or a possibility that a call might be made on callable capital? Congress has used a variety of mechanisms to effect the U.S. payments to international financial institutions – in some cases appropriating the full amount in budget authority, in other cases setting a program limitation on new liability, and in other cases treating the entire transaction as an off-budget exchange of assets. None of these arrangements seems to be superior to the others, either in terms of maintaining congressional control or in reflecting or controlling the liabilities that the United States faces through its participation in international financial programs.

[28] P.L. 97-35, enacted August 1981, adding Sec. 39 to the Bretton Woods Agreement Act. This authorized U.S. participation in a new capital increase for the World Bank, providing that 'any subscription to such additional shares shall be effective only to such extent or in such amounts as are provided in advance in appropriations acts." This is the same language Congress had chosen not to enact the previous year in connection with U.S. payments to the IMF.

In 2004, CBO Director Douglas Holtz-Eakin told the Senate Banking Committee that, "The current budgetary treatment does not fully reflect the U.S. share of the credit risk associated with the lending and other transactions of the international financial institutions." He had no recommendations for change, however. He said that CBO hoped to discuss these issues further in a future paper.[29] For various reasons, that study was never completed and no paper was released. It may be difficult, in the present moment, for Congress to determine what the "right" budgeting procedure might be in this situation. Over the longer term, however, Congress may want to consider whether an analysis of these budgetary issues might be desirable and whether some changes in the scorekeeping system for international financial institutions might be appropriate.

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[29] Statement of Douglas Holtz-Eakin, Director. Congressional Budget Office. *The Costs and Budgetary Treatment of Multilateral Financial Institutions' Activity*. Testimony before the Senate Committee on Banking, Housing and Urban Affairs, May 19, 2004. A copy of this testimony is available at http://www.cbo.gov/ftpdocs/54xx/doc5458/05-19-MFIs.pdf. CBO's last scored IMF legislation in 1998 when it considered H.R. 3114, the International Monetary Fund Reform and Authorization Act of 1998, a bill that was reported by committee but not considered by the House. A copy of the CBO cost estimate is available http://www.cbo.gov/ftpdocs/3xx/doc385/H.R.3114.pdf.