QUARTERLY REPORT TO CONGRESS ON FINANCIAL IMPLICATIONS OF U.S. PARTICIPATION IN THE INTERNATIONAL MONETARY FUND

SEPTEMBER 1, 2000

This report has been prepared in compliance with Section 504(b) of Appendix E, Title V of the Consolidated Appropriations Act for FY 2000[1]. As required, the report provides financial information on the net interest and valuation changes associated with U.S. participation in the International Monetary Fund (IMF). The methodology used in deriving these figures is laid out in the text that follows and in the footnotes attached to the table. Reports going forward will be prepared quarterly and will be made available to the public on the Treasury website: http://www.treas.gov.

The report focuses exclusively on the financial implications of U.S. participation in the IMF and does not attempt to quantify the broad and substantial economic benefits to the United States and the global economy resulting from U.S. participation in the IMF.

This report covers the quarter ended June 30, 2000. In addition, because this is the first quarterly report under section 504(b), it also includes the historical context of U.S. participation in the IMF, with data extending back to the beginning of U.S. fiscal year 1981.

Transactions under the U.S. Quota and Supplemental Borrowing Arrangements

Consistent with past practice in providing information to Congress on the financial implications of U.S. participation in the IMF – namely in the context of proposed quota increases -- this report focuses on participation in the IMF's General Department through its quota subscription and through supplemental borrowing arrangements. The United States also holds Special Drawing Rights[2] (SDRs) as part of its international reserves through its participation in the SDR Department of the IMF.

The quota is the financial subscription that each member must pay upon joining the IMF. Each country's quota is based on a set of criteria that relate to various dimensions of its relative size in the world economy. Quotas are generally reviewed every five years, with general increases occurring when necessary for the IMF to have additional liquidity available to serve its role in the international monetary system.

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[1] Section 504(b) of Appendix E, Title V of the Consolidated Appropriations Act for FY 2000, Public Law 106-113, 113 Stat. 1501A-317 requires that the Secretary of the Treasury prepare and transmit to the appropriate committees of the Congress a quarterly report on the costs or benefits of United States participation in the International Monetary Fund (IMF), detailing the costs and benefits to the United States, as well as valuation gains or losses on the United States' reserve position in the IMF.

[2] The SDR is an international reserve currency asset created by the IMF and used as a unit of account by the IMF and other international organizations. Its value is determined by a basket of currencies -- the dollar, euro, pound sterling and yen.

When its quota in the IMF increases, the United States normally is required to pay 25 percent of the increase in reserve assets (such as SDRs or certain foreign currencies)[3] and the remainder in domestic currency. The domestic currency element takes the form of an increase in the non-interest-bearing letter of credit available to the IMF.[4] The IMF draws dollars from the letter of credit as necessary to help finance its operations. When currencies are transferred by the United States to the IMF through the 25 percent reserve asset payment or through encashment of the letter of credit, the United States simultaneously receives an equal, offsetting claim in the form of an increase in the U.S. reserve position in the IMF. The reserve position, including any increases resulting from encashment of the letter of credit, is interest-bearing and liquid – and can be drawn at any time in case of a balance of payments need.[5]

In addition to quota subscriptions, the IMF maintains borrowing arrangements to supplement its resources under certain circumstances. The United States currently participates in two such arrangements – the General Arrangements to Borrow (GAB) and the New Arrangements to Borrow (NAB).[6] These supplemental arrangements make possible temporary support for IMF lending operations in times of crisis when IMF liquidity is low, such as in 1998. All U.S. loans to the IMF made under these borrowing arrangements have been repaid in full.

Under budget and accounting procedures established by the Congress at the time of the 1980 increase in the U.S. quota, an increase in the U.S. quota or in the U.S. portion of a supplemental borrowing arrangement requires budget authorization and appropriation for the full amount of the increase. However, consistent with budgetary practices developed with and adopted by the Congress in the 1960s, U.S. transactions with the IMF relating to the U.S. quota and the supplemental borrowing arrangements (GAB and NAB), are treated as exchanges of monetary assets and thus are not considered to result in net budgetary outlays. This is because the United States receives an equal offsetting claim on the IMF in the form of an increase in the U.S. reserve position in the IMF, which, as indicated above, is interest bearing and can be drawn at any time in case of a balance of payments need – and in practice has been drawn under such circumstances. Similarly, when the IMF transfers dollars to the United States, no net budget receipt results because the U.S. reserve position declines simultaneously by an equal amount.

Calculating the Financial Implications of U.S. Participation in the IMF

A number of elements go into calculating the financial implications of U.S. participation in the IMF.

- Interest foregone on reserve assets transferred to the IMF.
- Interest paid on increased borrowing to finance U.S. transfers of dollars to the IMF (under the letter of credit, as part of the quota subscription) and U.S. loans to the IMF (under the GAB or NAB).

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[3] In 1978, members were allowed to pay for the quota increase entirely in their own currency, and the United States paid in the 25 percent in U.S. dollars instead of in SDRs or foreign currency.

[4] Approximately one quarter of one percent of quota is maintained in cash dollars.

[5] A member's request to make a purchase from the resources represented by its reserve tranche based upon a balance of payments need is given the "overwhelming benefit of any doubt" by the IMF.

[6] The United States also participated in the Supplemental Financing Facility, which existed from 1979-84.

- Interest received on the U.S. reserve position in the IMF.
- Changes to the value of the U.S. reserve position in the IMF, as a result of fluctuations in the value of the U.S. dollar relative to the SDR. (The dollar value of the reserve position goes up when the dollar depreciates and declines when the dollar appreciates.)

Net Interest Calculations

When the United States transfers reserve assets to the IMF to satisfy obligations resulting from a quota increase, the United States incurs a decrease in interest-bearing assets. The SDR interest rate[7] is used in calculating the interest foregone, since assets transferred are either SDRs or currencies that make up the SDR.

When the IMF draws on its letter of credit with the United States, the Treasury finances the cash transfer by borrowing from the public through additional issuance in the Treasury market. The three-month Treasury Bill rate is used as a proxy for calculating the interest cost, since drawings on the letter of credit are incremental calls on Treasury cash balances, and the three-month Treasury Bill market is the shortest, deepest market for adjusting cash balances. Such a short-term approach to financing IMF drawings is appropriate since the resultant increases in the U.S. reserve position in the IMF can be reversed at any time to meet U.S. balance of payments needs, and since the IMF can transfer dollars back to the United States, replenishing the letter of credit at any time.

When the United States provides financing through the supplemental borrowing arrangements (GAB or NAB), the transactions are similarly financed through additional debt issuance. Again, when the IMF transfers dollars back to the United States in repaying GAB or NAB loans, the U.S. cash position is improved and borrowing requirements are reduced.

The United States earns interest on its reserve position in the IMF, including the increases in the reserve position that result when the letter of credit is drawn down by the IMF – although not on the portion of the reserve position originally paid in gold. [8] This interest is called "remuneration." Remuneration is paid quarterly and is calculated on the basis of the SDR interest rate. Payment of a portion of this remuneration is deferred as part of a mechanism for creditors and debtors to share any financial consequences of overdue obligations to the IMF, such as unpaid overdue interest, and to similarly share the burden of establishing contingency accounts to reflect the possibility of non-repayment of relevant principal amounts.[9] As overdue interest is paid, previously deferred remuneration corresponding to the creditors' share of the burden of earlier nonpayment is included in the next payment of remuneration. The deferred remuneration

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[7] The SDR interest rate is a weighted average of interest rates on short-term domestic obligations in the money markets of the five countries whose currencies constitute the SDR valuation basket – France, Germany, Japan, the United Kingdom and the United States.

[8] See Article V, Section 9 of the IMF Articles of Agreement.

[9] The IMF established the first Special Contingency Account in 1987 to further strengthen its financial position in view of the existence of overdue obligations. The IMF established the second Special Contingency Account (SCA-2) in 1990 to protect against risks associated with its new arrears strategy; accumulation of resources in SCA-2 ceased in 1997, and the account was wound up in 2000. The U.S. share of the SCA-2 was contributed to the IMF's HIPC Trust to help finance IMF participation in the HIPC initiative, with authorization from Congress in 1999.

corresponding to the creditors' share of establishing the contingency accounts will be paid in part when there are no longer any overdue obligations or when the IMF Executive Board determines. Generally, in recent years, the amount of remuneration payments deferred has been about 5 percent of accrued remuneration.

The United States also receives interest on any IMF borrowing under supplemental borrowing arrangements – the GAB and NAB. Loans extended under the GAB earn the SDR interest rate. Loans extended under the NAB earn the SDR interest rate or a higher rate if agreed by eighty percent of the participants in a particular loan.

Valuation Changes

Because IMF quotas, and transactions thereunder, are denominated in the SDR, fluctuations in the respective values of the dollar and SDR result in valuation gains or losses for the U.S. reserve position. When the SDR appreciates against the dollar, a valuation gain is recorded on the U.S. reserve position in the IMF because the dollar value of the reserve position has risen. When the SDR depreciates against the dollar, a valuation loss is incurred.

Because the domestic currency portion of the U.S. quota – effectively the letter of credit – is also denominated in SDRs, but payable in U.S. dollars, periodic adjustments are made to maintain the SDR value of the letter of credit in terms of dollars. These adjustments do not involve a flow of funds.

Overall Outcome

To help assess the overall financial implications of U.S. participation in the IMF, we have provided "totals" reflecting the sum of net interest and valuation changes. The nature of these figures differs, insofar as net interest generally reflects actual flows and valuation changes reflect unrealized resources. Economic theory suggests that this total should result over time in neither net gains nor net losses as exchange rates among major currencies are generally expected to move in line with interest differentials. According to this theory, the currency of a country with a lower interest rate is expected to appreciate against the currency of a country with a higher interest rate in an amount that would offset the interest differential. In practice, however, differentials in exchange rates and exchange rates rarely fully offset one another for any given period. Hence, the computations reported below result in substantial fluctuations, with significant totals, either positive or negative, often arising at any given point in time.

Overview of the Table

The attached table shows the net interest and valuation changes on an annual and quarterly basis, respectively; the attached footnotes explain the columns shown on each table and provide pertinent information and assumptions used in the calculations.

As shown in the attached table, annual interest foregone or paid as a result of financing U.S. transactions with the IMF averaged $509 million over the period FY 1981 through FY 1999, while annual remuneration received averaged $452 million, and annual interest received from the

IMF on loans extended by the United States averaged $48 million. Net valuation changes to the United States in the U.S. reserve position in the IMF averaged $85 million annually.

For the fiscal year ended September 30, 1999 (FY1999), net interest paid was $43 million. At the same time, the dollar value of the reserve position increased by $145 million as a result of valuation changes.

For the first quarter of the fiscal year beginning on October 1, 1999 (FY 2000), the net interest effect was negative $14 million, and the valuation change was negative $227 million. In the second quarter, the net interest effect was negative $19 million, and the valuation change was negative $316 million. In the third quarter, the net interest effect was positive $9 million, and the valuation change was negative $132 million. The trend in FY 2000 principally reflects appreciation of the dollar against the SDR.

Attachments

Net Interest and Valuation Changes Related to US Participation in the IMF, US Fiscal Year Basis
(in millions of US Dollars)

	Transactions with the IMF			Interest Calculations				Valuation Changes	Totals
Fiscal Year ending 9/30	Transactions Under US Quota (Letter of Credit &Transfers of Reserve Assets, Cumulative)	US Loans to IMF Under SFF, GAB, NAB (Cumulative)	Total US Transactions with IMF (Col. 1+2)	Interest Associated with Financing US Transactions with IMF	Remuneration Received by US from IMF & Refund of Burden Sharing	Interest Received from IMF Under SFF, GAB, and NAB	Net Interest (Col. 4+5+6)	Valuation Changes on US Reserve Position	Total (Col 7+ 8)
	Col. 1	**Col. 2**	**Col. 3**	**Col. 4**	**Col.5**	**Col.6**	**Col. 7**	**Col. 8**	**Col. 9**
1981	-2,061	-840	-2,902	-188	22	45	-121	-365	-485
1982	-3,883	-1,186	-5,069	-491	216	121	-153	-323	-476
1983	-6,564	-1,685	-8,249	-637	345	138	-154	-150	-304
1984	-9,501	-1,601	-11,102	-1,003	673	175	-155	-565	-720
1985	-9,102	-1,405	-10,507	-888	644	154	-90	547	457
1986	-8,073	-1,052	-9,125	-659	595	111	47	1,444	1,491
1987	-6,904	-597	-7,501	-480	449	71	40	575	615
1988	-5,846	-217	-6,063	-403	406	49	53	135	188
1989	-5,262	-3	-5,265	-456	471	22	37	-67	-30
								FY1981-89	*734*
1990	-4,686	72	-4,614	-428	546	4	123	738	861
1991	-5,078	72	-5,006	-349	475	0	126	-178	-52
1992	-5,068	72	-4,996	-264	400	0	136	687	823
1993	-7,752	72	-7,680	-321	422	0	101	-336	-235
1994	-7,310	72	-7,238	-307	336	0	29	394	423
1995	-9,649	72	-9,577	-408	407	0	-1	270	269
1996	-11,051	72	-10,979	-471	475	0	4	-695	-691
1997	-10,433	72	-10,361	-467	438	0	-28	-787	-815
1998	-17,363	-410	-17,773	-711	590	1	-121	151	30
1Q99	*-18,378*	*-1,278*	*-19,655*	*-193*	*187*	*5*	*-1*	*570*	*569*
2Q99	*-19,743*	*52*	*-19,691*	*-205*	*175*	*10*	*-20*	*-831*	*-851*
3Q99	*-18,336*	*52*	*-18,284*	*-185*	*167*	*6*	*-13*	*-378*	*-391*
4Q99	*-16,058*	*52*	*-16,006*	*-166*	*157*	*0*	*-9*	*784*	*775*
1999	-16,058	52	-16,006	-749	686	20	-43	145	102
								FY1990-99	*715*
								FY1981-99	*1,449*
Annual Average (FY 1981-99)				-509	452	48	-9	85	76
1Q00	*-14,263*	*52*	*-14,211*	*-161*	*147*	*0*	*-14*	*-227*	*-241*
2Q00	*-14,484*	*52*	*-14,432*	*-167*	*148*	*0*	*-19*	*-316*	*-335*
3Q00	*-11,301*	*52*	*-11,248*	*-135*	*144*	*0*	*9*	*-132*	*-123*

Detail may not add to total due to rounding.

Footnotes to Columns

Column 1: Total cumulative transactions under the U.S. Quota, including drawings by the IMF under the Letter of Credit (75% portion of the U.S. quota) and the transfers of reserve assets to the IMF (generally 25% of the U.S. quota).

Column 2: Total cumulative dollar funding through loans to the IMF made by the U.S. under the Supplementary Financing Facility (SFF, in 1980), the General Arrangements to Borrow (GAB, in FY1998) and the New Arrangements to Borrow (NAB, in FY1999). U.S. loans under the three facilities/arrangements have all since been repaid. The positive totals in years 1990 through 1997 and beginning again in the second quarter of 1999 reflect the fact that principal repaid exceeded principal lent, due to changes in the relative value of the dollar with respect to the SDR.

Column 3: Total cumulative U.S. transactions with the Fund (horizontal summation of columns 1 and 2).

Column 4: Total interest associated with total cumulative transactions shown in column 3. This includes interest paid on additional public borrowing to fund day-to-day transactions under the Letter of Credit and occasional transfers under loan arrangements (SFF, GAB, NAB), as well as interest income foregone due to the transfer of reserve assets to the IMF at the time of a quota increase. In order to provide resources under the Letter of Credit or under loan arrangements, the Treasury borrows from the public via additional issuance in the Treasury market; the three-month Treasury Bill rate is used as a proxy for calculating the associated interest cost. This portion of the total interest paid enters the U.S. budget as interest on the public debt. For purposes of calculating foregone interest on the transfer of reserve assets to the IMF, the SDR interest rate is used.

Column 5: The U.S. earns interest on the non-gold portion of its reserve position in the IMF. This interest is called remuneration and, in combination with an adjustment by the IMF related to burden-sharing, is paid by the IMF every quarter. If remuneration is paid in SDRs, it is paid to the Exchange Stabilization Fund (ESF) and the ESF transfers the dollar equivalent to the Treasury General Fund. It is recorded in the budget as an offsetting receipt from the public. If the United States took payment in dollars (which it does not now do) the payment would be in the form of a decrease in the U.S. Letter of Credit (which would translate into an increase in the U.S. reserve position).

Column 6: These amounts constitute the interest payments the United States has received on its loans to the IMF under the SFF, GAB, and NAB.

Column 7: Total net interest paid, foregone or received as a result of U.S. participation in the General Department of the IMF.

Column 8: The U.S. reserve position in the IMF is denominated in SDRs. The valuation gain (if positive) or loss (if negative) refers to the exchange rate gain or loss on the reserve position due to changes in the dollar value of the SDR. For example, if the SDR appreciates/dollar depreciates, then the U.S. budget impact is a gain, as the dollar value of the reserve position has risen.

Column 9: The total of net interest and valuation changes, obtained by summing the column 7 and column 8.