Testimony of Martin A. Weiss, Specialist in International Trade and Finance, Congressional Research Service, before the House Committee on Financial Services Hearing on "The Role of the International Monetary Fund and Federal Reserve in Stabilizing Europe"

Chairmen Meeks and Watt, and Ranking Members Miller and Paul, thank you for the opportunity to provide written testimony for your hearing, "The Role of the International Monetary Fund and Federal Reserve in Stabilizing Europe." The following provides a discussion of the International Monetary Fund's (IMF) lending resources; recent lending to Greece; and possible IMF commitments to the new European Stabilization Mechanism.

Background

The international monetary system has changed significantly since the founding of the IMF in July 1944. Late in World War II, delegates from 44 nations gathered in Bretton Woods, New Hampshire, to discuss the postwar recovery of Europe and create a set of international institutions to resolve many of the economic issues—such as protectionist trade policies and unstable exchange rates—that had ravaged the international economy between the two world wars. As the global financial system has evolved over the decades, so has the IMF. From 1946 to 1971, the main purpose of the IMF was to manage the system of fixed exchange rates agreed to at Bretton Woods. The U.S. dollar was fixed to gold at $35 per ounce and all other member countries' currencies were fixed to the dollar at different rates. The IMF monitored the macroeconomic and exchange rate policies of member countries and helped countries overcome balance of payments crises with short-term loans that facilitated policy adjustments to take effect in reducing external imbalances.

This system came to an abrupt end in 1973 when the United States floated its currency and, after a period of instability, the modern system of floating exchange rates came into effect. The IMF adapted to the end of the fixed exchange rate system by shifting its focus to promoting a stable exchange rate system based on floating exchange rates, while continuing to provide temporary balance of payments financing to countries, including to those afflicted by capital account crises.

Current IMF operations and responsibilities can be grouped into three areas: surveillance; lending; and technical assistance. Surveillance involves monitoring economic and financial developments and providing policy advice to member countries. Lending entails the provision of financial resources under specified conditions to assist a country experiencing balance of payments difficulties. Technical assistance includes help on designing or improving the quality and effectiveness of domestic policy-making.

The United States is the largest single country contributor to the IMF, subscribing to around $55 billion of IMF quota, 17.09% of the total IMF quota. It has a single seat on the IMF's Board of Executive Directors and 16.74% of the total votes in IMF decision making.[1] The U.S. Executive Director (ED), Meg Lundsager, is the primary U.S. representative to the IMF. She sits on the Executive Board, which is comprised of 24 Directors representing all of the IMF's 186 members and handles the day-to-day

[1] IMF Executive Directors and Voting Power, International Monetary Fund, March 12, 2010.

operations of the Fund. The majority of IMF decisions, including country loans, require a 50% majority vote. Special matters, such as gold sales or approval of new quota increases, require an 85% majority vote. Some decisions require a 70% majority, e.g., changes in charges on lending. Congressional authorization is required by law before the United States may agree to participate in any new IMF funding agreements. Changes in the Articles of Agreement (Articles) that define the operations the IMF may conduct, and the majorities required for various decisions, may be proposed by the Executive Board, but require acceptance by at least three-fifths of member countries with at least 85% of the voting power before they are effective. Only four amendments to the Articles have been made in the history of the IMF, while two amendments are currently in the process of being approved by members.

IMF Lending

In the years following the Asian financial crisis (1997-1998) and financial support for Latin American countries in early 2000s, the volume of IMF lending fell substantially. International trade boomed, many emerging market countries accrued large financial reserves, and global capital flows grew substantially. By the end of September 2008, outstanding IMF credit was $11.5 billion, down from a peak of $116 billion in September 2003. Weak demand for IMF loans, together with large early repayments of credit resulted in income shortfalls relative to the IMF's administrative budget in 2007-2008. As part of a 2008 reform package, a restructuring was implemented to lower expenses by US$100 million, primarily through a roughly 20% reduction in IMF staff. Since the onset of the financial crisis in late 2008, however, the IMF has made record volumes of credit commitments as both developing and advanced economies have turned to the IMF for balance of payments assistance. Between October and December 2008, credit outstanding almost doubled, from $17.1 billion to $32.54 billion and has continued to rise steadily. Following the IMF loan to Greece, total IMF financial commitments, including precautionary facilities, now exceed $180 billion.[2]

Current IMF Resources Available to Lend

As of May 13, 2010, the IMF has around $239.26 billion dollars immediately available to lend.[3] This figure is the IMF's one-year forward commitment capacity (FCC), which measures the IMF's ability to make new non-concessional loans available to members over the next 12 months. This includes, among other sources, quota resources, unused amounts available under currently active bilateral loans to the IMF from several advanced economies, and note purchase agreements with three large emerging market countries.[4]

Quota

Quotas are the primary national contributions to the IMF and are the foundation of a country's participation in the institution. Quotas are in effect lines of credit upon which the IMF can draw to finance its lending operations. Based on each country's size in the global economy, quotas determine: (1) the amount of financial resources each member is required to contribute to the Fund; (2) the amount of financing a member may receive from the Fund;[5] and (3) the voting power each country has at the IMF.

[2] "IMF Financial Activities -- Update May 13, 2010," *International Monetary Fund*, May 13, 2010. Available at http://www.imf.org/external/np/tre/activity/2010/051310.htm.

[3] 161.7 billion IMF Special Drawing Rights (SDR) at an exchange rate of $1.47965 on May 13, 2010.

[4] The FCC is defined as the Fund's stock of usable resources less undrawn balances under existing non-concessional credit arrangements, plus projected repurchases during the coming 12 months, less repayments of borrowing due one-year forward, less a prudential balance intended to "safeguard the liquidity of creditors' claims and to take account of any erosion of the Fund's resource base." "The Fund's Liquidity Position – Review and Outlook," *International Monetary Fund*, April 12, 2010. Available at http://www.imf.org/external/np/pp/eng/2010/041210.pdf.

[5] Over time, this linkage has weakened and several countries have been granted special access, allowing them to borrow several times their IMF quota. Argentina, for example borrowed more than five times its quota in 2002. In addition, the poorest countries borrow from the IMF under the Fund's concessional facility, the Poverty Reduction and Growth Facility (PRGF). The resources

The total of all member countries' quota subscriptions is 217.43 billion IMF Special Drawing Rights (SDR), approximately $318.75 billion.[6] The current U.S. quota at the IMF is SDR 37.14 billion, approximately $55 billion, 17.09% of total IMF quota.

Since the IMF's founding, it has been the stated intention of the IMF to base quotas on various formulas that technically deduce a country's ability to contribute to the IMF and its potential need to draw on IMF resources. Historically, quotas have been loosely guided by the calculated quotas and actual quotas are driven by political negotiations among the member countries. In April 2008, IMF members completed two years of negotiations and agreed to quota increases for 54 countries that were underrepresented at the IMF on the basis of a new formula. This quota reform can become effective following an amendment to the IMF's Articles. Proposed amendments would enter into force for all members once three-fifths of the members (112), having 85% of the total voting power, have accepted the proposed amendment.[7] In some countries, including the United States, legislative approval is required before a country can accept a proposed amendment. When fully implemented, these reforms would increase the total IMF quota by 11.5%.[8]

In October 2009, IMF members endorsed a call by G-20 leaders for an additional shift in quota share to dynamic emerging and developing countries of at least 5% from over-represented countries to under-represented countries.[9]

Countries contribute to the IMF mainly in local currency. Since the external positions (balance of payments and international reserves) of many emerging market and developing countries are weak, the IMF selects a group of countries (currently 54), which is reviewed quarterly, whose quota can be drawn on to finance IMF loans. The total quota of member countries that can be used for IMF lending is SDR 179.7 billion or $269.1 billion, and is around 83% of total quota.

Extending an IMF loan using quota resources involves a transfer of foreign exchange from creditor members to the IMF and then a transfer from the IMF to its borrowing members. These transfers reduce the available quota resources from creditors and increase their reserve positions with the IMF by the same amount. Creditor members receive a market-related return on their reserve positions with the IMF. The amounts transferred and received by these members are managed to ensure that their reserve positions in the IMF remain broadly even in relation to their quota, which are reported by the IMF on a quarterly basis. As of January 31, 2010, SDR 7.33 billion (approximately $10.85 billion, 19.7% of total usable quota) of U.S. quota is being used to finance transactions.[10]

Existing New Arrangements to Borrow and General Agreements to Borrow

In addition to its regular quota resources, the IMF maintains two standing multilateral borrowing arrangements—the New Arrangements to Borrow (NAB) and the General Arrangements to Borrow (GAB)—currently with a total borrowing capacity of about $52 billion.[11] These are backstop resources

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for the PRGF do not come from quotas and are not restricted by any limits.

[6] Special Drawing Rights (SDR) are the IMF's unit of account. Initially defined as equivalent to 0.888671 grams of fine gold, the value of the SDR was switched to a basket of international currencies following the collapse of the Bretton Woods system of fixed parity exchange rates in 1973. The current basket includes the euro, Japanese yen, the British pound sterling, and the U.S. dollar.

7 Only four amendments to the Articles of Agreement have been made in the history of the IMF.

[8] Currently 70 IMF member nations have accepted the proposed Voice and Participation amendment (which would triple the basic votes of members and provide an additional alternate Executive Director to the two constituencies, currently African, with the most members). In order to maintain its 17.09% share of total quota, the United States will subscribe to an additional $8 billion in IMF quota. Necessary authorization and appropriation are included in the Supplemental Appropriations Act (P.L. 111-32).

[9] CRS Report R40977, *The G-20 and International Economic Cooperation: Background and Implications for Congress*, by Rebecca M. Nelson.

[10] Financing IMF Transactions Quarterly Report (November 1, 2009 – January 31, 2010), *International Monetary Fund*, http://www.imf.org/external/np/tre/ftp/2010/050110.htm.

[11] The NAB is the first line of recourse and it totals $52 billion—the GAB does not provide additional resources.

intended to temporarily supplement available quota resources and borrowing. If activated, participating creditor 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 GAB/NAB creditors.

Under current rules, before the IMF can draw against these resources, countries representing 80% share of total credit volume and also a majority of the IMF Executive Board must agree to their use. The NAB has been activated once—to finance a loan to Brazil in December 1998 as a short-term bridge to an increase in quotas. The GAB has been activated 10 times. The last time was in July 1998 for Russia. Current U.S. commitments to, and voting share at, the GAB are $6.33 billion (25%) and to the NAB are $9.89 billion (19.5%). Hence, given the requirement for support from an 80% majority of credit arrangements, the United States can in practice prevent the current GAB/NAB resources from being activated.

Increasing IMF Lending Resources

In April 2009, the G-20 Leaders and the International Monetary and Financial Committee agreed to increase the resources available to the IMF through immediate bilateral financing from members and to subsequently expand the NAB and make it more flexible. Although resources from most pledged bilateral financing are available and being drawn on for current IMF programs, the expanded NAB is not yet operational.

Bilateral Contributions

To date, around $259 billion in bilateral arrangements are in effect, and are being used with IMF quota resources to fund IMF loans. These arrangements include loan agreements with 16 countries and note purchasing agreements with three countries. Additional bilateral pledges are under discussion. The IMF has decided in its current Financial Transactions Plan (FTP) that disbursements under Fund-supported programs will draw equally between quota and borrowed resources (bilateral loans to the IMF and note-purchases).

Expanded New Arrangements to Borrow

Following a year of negotiations on the design and operations of the expanded NAB, the IMF Executive Board adopted a proposal on April 12, 2010, by which the NAB would be expanded from about $550 billion, with the addition of 13 new participating countries.[12] The U.S. commitment to the expanded NAB is $100 billion and the necessary authorizations and appropriations were enacted in FY2009.[13] In order to become operational, the expanded NAB requires both consent from current participants representing 96% of total (current) credit arrangements and adherence of new participants representing 70% of the total credit arrangements of new participants. Once the expanded NAB becomes operational, the bilateral loan and note purchase agreements would expire. The U.S. share in the expanded NAB, assuming that all participants agree to the amounts stated in the April 12, 2010 press release, would be 18.80% of the total expanded NAB.[14] Approval from an 85% majority of credit arrangements is required to activate the expanded NAB, so it cannot be activated without U.S. approval.

IMF Loan to Greece

[12] IMF Executive Board Approves Major Expansion of Fund's Borrowing Arrangements to Boost Resources for Crisis Resolution, *International Monetary Fund*, April 12, 2010.

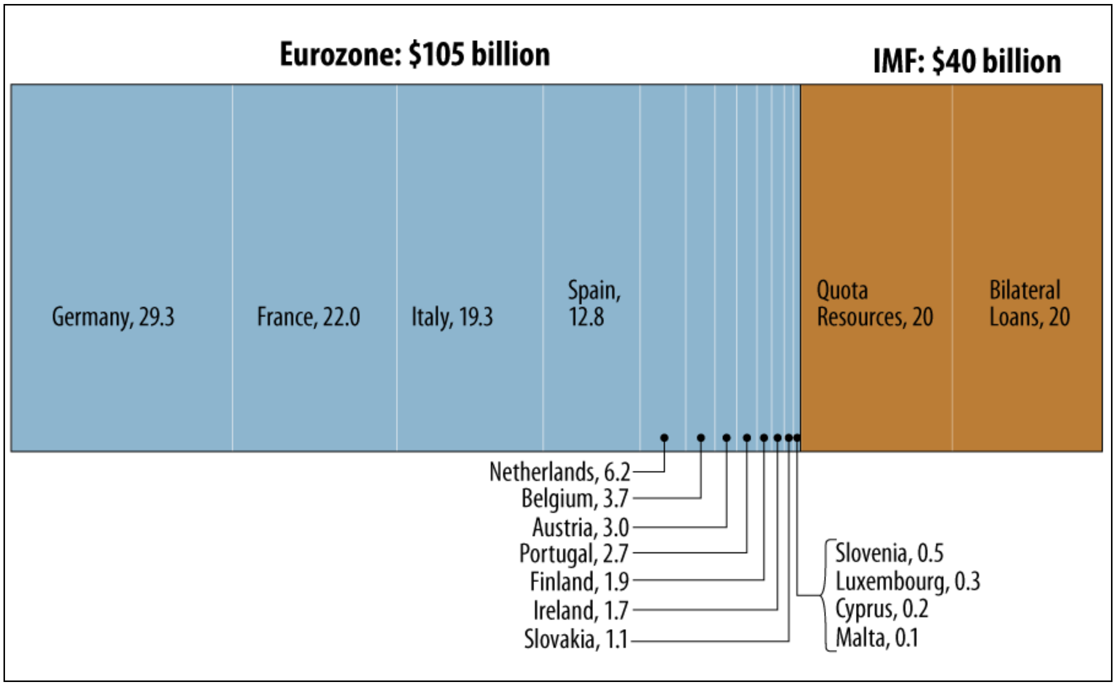
[13] To meet the U.S. $100 billion commitment to the expanded NAB, as well as an $8 billion increase in the U.S. quota at the IMF, Congress appropriated $5 billion in the FY2009 Spring Supplemental Appropriations for Overseas Contingency Operations (P.L. 111-32).

[14] IMF Executive Board Approves Major Expansion of Fund's Borrowing Arrangements to Boost Resources for Crisis Resolution, *International Monetary Fund*, April 12, 2010.

On May 9, 2010, the IMF Executive Board approved a €30 billion (around $40 billion) loan for Greece as part of a total package with the European Union (EU) amounting to $145 billion over three years (**Figure 1**).[15] European countries will provide €80 billion (around $105 billion) and assistance will be disbursed to Greece on a fixed 3:8 ratio between the IMF and the EU.

Figure 1. Eurozone/IMF Financial Assistance Package to Greece

Eurozone member state and IMF source of resources, Billion US$



Source: Reuters and International Monetary Fund. Prepared by CRS.

Notes: Eurozone member state commitments are bilateral loans, and some commitments are subject to parliamentary approval. IMF quota resources and bilateral loans fund a Stand-By Arrangement (SBA) loan for Greece.

IMF disbursements to Greece will be financed in the same manner as other disbursements on recent IMF loans, using a mix of quota and borrowed resources, which as noted above, is currently set at a ratio of 1:1. Thus, for every $11 provided to Greece under the newly approved loan package, $8 will come from EU countries and the IMF will draw $1.5 from quota resources and $1.5 from resources borrowed by the IMF through bilateral loans and note purchases by member countries. Since the United States has no bilateral borrowing arrangements with the IMF, U.S. resources will not be used for the 50% of the IMF loan to Greece drawn on non-quota resources.

For the half of the IMF loan to Greece that is drawn from quota resources, U.S. quota can, and will likely be drawn on, to finance a portion of the loan. As discussed earlier in this testimony, the United States receives a market-related return on its creditor positions with the IMF. It is important to note that countries whose quota is drawn on to finance an IMF loan do not take any additional financial risk compared to other IMF members. The Fund's membership as a whole bears any risk from lending to Greece. Furthermore, member countries whose quota resources are chosen for a specific IMF loan have a claim on the Fund's balance sheet as a whole.

Since the IMF was established, no member of the Fund has experienced a loss from providing resources to the Fund, either by lending to the Fund or through the payment of quota subscriptions. This reflects the multi-layered safeguards on Fund lending, including policy conditionality and regular reviews of performance by the Board, together with the Fund's preferred creditor status, which means countries continue to service Fund credit even if they default on other debt.

[15] For more information on Greece, please see CRS Report R41167, *Greece's Debt Crisis: Overview, Policy Responses, and Implications*, by Rebecca M. Nelson, Paul Belkin, and Derek E. Mix.

IMF Resources Used for the European Stabilization Mechanism

Despite press reports of IMF contributions of €220 to €250 billion (about $279.38 to $317.47 billion) to Europe's newly announced European Stabilization Mechanism (ESM), the IMF has made no formal commitments.[16] According to IMF Managing Director Strauss-Kahn, any IMF contributions "will be on a country-by-country basis," and "through the whole range of instruments available to the IMF."[17] Any such commitments would also be subject to the approval of the Executive Board in the same manner as all IMF lending arrangements. If the IMF decides that loan programs for other European countries will be necessary, the IMF contribution will likely be on par with recent joint EU-IMF financing packages, where the IMF has provided roughly one-third of the total financing for the adjustment program, and the EU the remainder.

The European Stabilization Mechanism consists of two components:

- A new European Commission Facility that can provide up to €60 billion (about $76.20 billion) to eurozone members; and
- A €440 billion euro (about $558.76 billion) Special Purpose Vehicle that will be guaranteed on a pro rata basis by participating EU member states and will expire after three years.

[16] Ian Talley, "UPDATE: EUR250 Billion IMF Contribution To Europe Hypothetical-IMF's Lipsky," *Dow Jones Newswire*, May 11, 2010. See also "Transcript of a Press Briefing by International Monetary Fund First Deputy Managing Director John Lipsky on the Euro Countries Stabilization Measures," *International Monetary Fund*, May 10, 2010. Available at http://www.imf.org/external/np/tr/2010/tr051010.htm.

[17] IMF Welcomes European Actions to Stabilize Euro Area, *International Monetary Fund*, May 9, 2010.