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TRANSPARENCY AND THE FINANCIAL STRUCTURE OF THE INTERNATIONAL MONETARY FUND

HEARING

before the

JOINT ECONOMIC COMMITTEE CONGRESS OF THE UNITED STATES

ONE HUNDRED SIXTH CONGRESS

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Wednesday, July 21, 1999

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
WASHINGTON, D.C.

The Committee met pursuant to notice, at 10 a.m., in Room 311, Cannon House Office Building, the Honorable Jim Saxton, Vice Chairman of the Committee, presiding.

Present: Representatives Saxton, Sanford, Ryan, and Watt.

Staff Present: Christopher Frenze, Bob Keleher, Colleen Healy, Darryl Evans, Howard Rosen and Daphne Clones.

OPENING STATEMENT OF REPRESENTATIVE JIM SAXTON, VICE CHAIRMAN

Representative Saxton. Good morning.

It is a pleasure to welcome Mr. Johnson and his colleagues from the General Accounting Office (GAO) here before the Joint Economic Committee (JEC) once again. GAO testimony has been an important part of the JEC's program to provide more transparency to the financial structure of the International Monetary Fund (IMF). We very much appreciate their assistance.

The ongoing JEC review of IMF finances in recent years has involved much effort in seeking more transparency for IMF operations. I would like to thank Mr. Johnson and his GAO team for their hard work in helping the Congress to gain access to IMF information that for too long has neither been publicly available nor easily understandable.

I would like to just ask unanimous consent that my entire statement be placed in the record. In the interests of time, we will move right to Mr. Johnson's statement.

Sir, you may begin. Thank you very much for the great effort that you have put into this undertaking. We appreciate it very much, and we are anxious to hear from you.

[The prepared statement of Mr. Saxton appears in the Submissions for the Record.]

STATEMENT OF HAROLD J. JOHNSON, JR., ASSOCIATE DIRECTOR, NATIONAL SECURITY AND INTERNATIONAL AFFAIRS DIVISION, U.S. GENERAL ACCOUNTING OFFICE: ACCOMPANIED BY GARY T. ENGEL, ASSOCIATE DIRECTOR, ACCOUNTING AND INFORMATION MANAGEMENT DIVISION, PHYLLIS ANDERSON, SENIOR EVALUATOR, AND THOMAS MELITO, SENIOR ASSISTANT DIRECTOR

Mr. Johnson. Thank you very much for your comments.

Before I begin, I would like to introduce my colleagues.

To my immediate left is Gary Engel, who is an Associate Director with our Accounting and Information Management Division. He is jointly responsible with me for the overall work that we are doing in this area at the IMF.

To my right, immediate right, is Phyllis Anderson, a Senior Accountant, and Tom Melito, a Senior Economist, who have day-to-day responsibility for the work that we perform. I think most of our team wanted to participate in this hearing today, and they are behind me.

Before I begin my statement, you mentioned about the transparency that is gradually evolving at the IMF. I don't directly cover that in my statement, but I would like to comment that through the efforts of this Committee as well as others the IMF has become more transparent. They have some way to go yet, I believe, but they are making some progress in that area. They release a wide variety of information now with regard to their consultative process with countries as well as financial information. So I think you are making some headway in that regard.

My remarks today are basically based on work that we have done for this Committee as well as work that we have under way to meet the mandate of the *Omnibus Appropriation Act of 1999*. Since that work is ongoing, some of the information that I will present will be based on our preliminary analysis. We expect to complete that work and report to the committees that are cited in the legislation by September of this—by the end of September.

As you requested, today I am going to talk about the Fund's current situation regarding quotas, that is, the resources that the IMF obtains from its members and that it uses for most of its financial operations. I am going to discuss the level of resources that the Fund has reported as actually being available to lend and other resources that the Fund potentially has available for conducting its operations, such as resources obtained through borrowing and the Fund's gold holding.

Also, as you requested, I will provide some historical perspective highlighting the share of IMF financial resources that have been contributed by the G-10. Incidentally, the G-10 consists of 11 countries. When we get to the charts you will see 11 countries listed for the G-10.

Before I summarize my statement, I would just like to briefly go over some background information that I think places some of this in context and makes it more easily understood.

Quotas are the membership dues that countries pay to belong to the IMF and comprise the bulk of the Fund's resources. Up to 25 percent of the quotas are normally paid in reserve assets which are either special drawing rights (SDRs) or freely usable currencies. The balance may be paid either in the country's domestic currency or with noninterest-bearing promissory notes.

The portion paid in freely usable currency or in SDRs is referred to as the member's reserve tranche position. This can be drawn by the member as needed, and if withdrawn is to be replaced by the member's own currency. The members are not required to replenish the reserve tranche position.

When a member needs funds other than from its reserve tranche, IMF does not literally lend the money to the country. Rather, the country purchases the currency that it needs from the IMF with an equivalent amount of its own currency and then later repurchases its own currency using either SDRs or currency that is designated by the IMF. Because IMF's financial assistance is in the form of currency purchases, this transaction does not reduce the combined total of IMF's current holdings in terms of the SDR equivalents. Instead, the composition of the currency holding simply changes.

The IMF holds about 103 million ounces of gold, most of which it acquired prior to 1974 when its Articles of Agreement required that 25 percent of a member's quota subscription be paid in gold. The regular use of gold in IMF transactions ended in 1978 when its Articles of Agreement were amended to reflect the end of the fixed currency exchange rate system that had governed the international financial system up to that time.

The IMF values its gold at 35 SDRs per ounce. That is about, at the current exchange rate, about $47 an ounce, which was its value at the time it was acquired by the IMF. Therefore, IMF's gold holdings are valued on its balance sheet at about 3.6 billion SDRs or about $5 billion. However, the IMF reports in a footnote to its financial statements the current market value of gold holding, which incidentally on July 14, I believe, was about $26 billion. But, as you know, it has been fluctuating.

Now, I would like to summarize our main points.

On January 30 of 1998, the IMF Board of Governors approved a new quota level of 212 billion SDRs, which was a 45 percent increase from the prior quota of about 146 billion SDRs. The quota became effective in January of this year when members having 85 percent of the total quotas consented to the quota increase. As of April 30, which is the end of IMF's financial year, about five billion in quotas had not been paid to IMF by 27 members. Seven of those members are currently in protracted arrears and ineligible to consent or to pay their quotas until they become current on their obligations. In addition, there are 20 members who have not yet consented and have until the end of July this year to do so.

IMF quotas have grown substantially over the years. This growth has come from increased membership, eight general quota increases since 1959, and several special and ad hoc increases in quotas of individual members. General quota increases have ranged from about 34 percent to 61 percent.

The United States has historically contributed the largest amount of quota resources. However, the U.S. share of the quota has fallen from a high of about 39 percent of quotas, of total quotas, in 1945 to the current level of about 17.5 percent. The U.S. share has decreased primarily due to the expansion in membership over the years—152 new countries have joined since its founding. Nonetheless, the absolute size of the U.S. quota has increased, from about $2.8 billion in 1945 to $50 billion now. Those numbers are in nominal dollars. They are not inflated.

Figure one on page five of the prepared statement shows that growth. We have a graphic that shows how the growth has occurred over the years. Now, the dark columns represent inflation-adjusted dollars, or real dollars, and the white, (which is a little difficult to see) represent nominal dollars.

In July last year, we testified that about $43 billion of IMF's resources were actually available at that time for lending or for other purposes. Today, I want to update that figure to April 30.

As before, the IMF begins with its total amount of resources. I am going to cite these in dollars so it is a little easier to visualize. Its total resources are about $287 billion as of April 30. IMF estimates that, before considering the credit that has already been extended, about $195 billion, or 68 percent, is usable. This is shown in figure two of the prepared statement on page six.

The usable resources consist of (1) currencies of members considered by the Executive Board to have sufficiently strong balance of payments and reserve positions for their currencies to be used in IMF's operations and (2) IMF's holdings of SDRs. The remaining $92 billion of resources is considered unusable. That would be the white wedge in the pie chart.

This unusable amount consists of currencies of members that are currently using IMF resources and are therefore in a weak balance-of payment position; currencies of members in relatively weak external positions; gold holdings of the Fund which require an 85 percent vote by the Executive Board to be used; and other nonliquid assets such as buildings, facilities, and that type of thing.

Over the past 10 years, from 29 to 39 countries have had currencies sufficiently strong to be used in IMF's operations. These percentages are shown in figure 3 on page seven of the prepared statement.

About 77 percent of the resources IMF deems usable were contributions by the G-10. The United States is the single largest contributor of usable resources with about 26 percent of the total.

Thus, as I have indicated, as of April 30, 1999, IMF had $195 billion of total usable resources to meet—first of all, requests for funds and, second, to meet possible requests by creditor members for their reserve assets. IMF takes several steps to calculate the available and uncommitted resources referred to as liquid resources. That is shown on table 1.

The IMF first reduces the total usable resources by the amount of outstanding credit extended, in this case about $81 billion, to determine available resources. It then reduces its available and usable resources by $18 billion for commitments that are already made to countries and by about $19 billion for a minimum working balance reserve that IMF believes is necessary to make payments in specific currencies. The minimum working balance is set at 10 percent of the quotas of members in a strong external and reserve position. This is shown graphically in figure 4 on page eight of the statement.

Over the past 20 years, the amount of usable and unusable resources has varied. Usable resources over the period has averaged about 60 percent of the total resources, with a significant portion being from the G-10. This is shown in figure 5 on page nine of the prepared statement.

The United States has been the major contributor to these resources. The U.S. portion is represented by the very dark line at the bottom of the bar graph.

IMF can also borrow to conduct its operations but historically has done so only from official sources. The Fund has not borrowed from private capital markets, although the Articles of Agreement permit it to do so, because, according to the Fund, it is a cooperative governmental institution whose basic purpose is to facilitate the overall adjustment process using surpluses to assist countries in deficit positions.

IMF first activated its general arrangements to borrow credit lines in 1964, and during the 1970s financed from 45 to 62 percent of its credit through borrowing. Since 1985, IMF has decreased its borrowing substantially and between 1992 and 1997 did no borrowing.

IMF resumed borrowing in July 1998 when it borrowed $2 billion through the General Arrangements to Borrow (GAB) process to finance assistance to Russia and again in December 1998 when it borrowed about $4 billion through the New Arrangements to Borrow (NAB) for Brazil. Both of these amounts were repaid in March of this year after IMF received funds from its quota resources.

I will turn just briefly to the gold issue.

IMF stresses the importance of gold as a reserve asset for the Fund. In 1995, IMF's Executive Board reviewed the Fund's position on holdings of gold as a reserve asset and announced several principles for managing gold reserves. These principles are that, one, gold provides a fundamental strength of the IMF; two, gold provides operational maneuverability in the IMF's use of its resources and adds credibility to its precautionary balances; three, gold should be held to meet unforeseen contingencies; four, IMF has a responsibility to avoid disruption in the functioning of the gold market; five, profits from gold sales should be retained and only the income from such profits or investments of those profits should be used for agreed-upon purposes.

Over the years the IMF has sold gold for a variety of reasons. On several occasions it had to replenish its currencies in the early 1950s and 1960s and used gold to buy those currencies. Also, it sold gold to generate some income needed to offset some operational deficits. And then between April 1976 and May 1980 IMF sold 25 million ounces of gold at auction to finance an IMF trust fund which had been created to support concessional lending to low income countries. Finally, between 1977 and 1980, the IMF restituted 25 million ounces in gold in four annual installments to members in proportion to their relative quota shares as of August 31, 1975. The United States received an acquisition of 5.74 million ounces of gold in that transaction.

There have been several recent proposals to sell gold. These are discussed at some length in our prepared statement. But in order to preserve more time for questions and answers, I will not discuss the current proposals. If you would like to ask questions about them, we are prepared to respond.

That concludes my prepared remarks, and we are ready to attempt to answer your questions.

[The prepared statement of Mr. Johnson appears in the Submissions for the Record.]

Representative Saxton. Mr. Johnson, first, let me thank you for a very clear and understandable statement.

Let me also say that you mentioned that the IMF has become somewhat more transparent. We would like to thank you and your team for the hard work that you have put into this undertaking because, without the hard work that you have done, the understanding that this Committee and the Congress has gained would not have been possible. We thank you for that.

Let me ask you some questions about several items that you have made reference to.

First, sometimes official sources state that the United States contributes about 18 percent, I think it was 17.5 percent in your statement, as that would be our percent of the IMF quotas. However, it is also true, is it not, that if one were to set aside contributions that are not usable or useless, isn't the United States' contribution 26 percent? I believe you said that in your statement.

Mr. Johnson. Yes, that is correct. Twenty-six percent of those resources that are usable within the operational budget. The countries that are in and out of the operational budget fluctuate from time to time but, basically, on the margin. There are generally a fixed number of countries that are part of the operational budget that primarily support the Fund.

Representative Saxton. As a matter of fact, figure 3 in your statement, which you also had up on the board, shows the United States' contribution in terms of usable quota to be 26 percent. Then the next largest would be Germany at only 9 percent; is that correct?

Mr. Johnson. Yes, that is correct.

Representative Saxton. And the United Kingdom would be next with 7 percent. So it shows that by far and away the United States' usable contribution is several times that of the next contributor.

Mr. Johnson. Yes, that is correct.

Representative Saxton. Under IMF rules, 25 percent of the quotas are paid in usable resources. However, isn't it the case that some countries, such as the United States, contribute more than 25 percent of quota in usable resources while other countries maintain virtually no contribution in hard currency?

Mr. Johnson. Well, the way that the process works is that, when a quota or subscription is agreed to, all countries have to provide 25 percent in hard currency or in SDRs. However, countries that are in a weak financial position or are borrowers sometimes are able to obtain those hard currencies or SDRs through some other means, make their payment and draw those funds out again. That is reflected, I believe, on tables at the end of the statement that show those countries that are creditor, the ones that are in a neutral position and those that are in a debtor position. They have basically drawn all of those funds out.

Representative Saxton. Now, as we all know, there has just been a quota increase. Nonetheless, about 88 percent or nearly half of the IMF members have a reserve position of less than 5 percent of quota, with many of these below 1 percent of quota and some at actually zero. Apparently, many of these nations borrow their reserve contributions to satisfy membership requirements and immediately withdraw it and repay lenders, including the United States.

Is this the case and if so, wouldn't it be more straightforward to just waive the IMF contribution rules if they are just going to be evaded anyway? What is the point in maintaining rules that suggest broad-based financial support when this is really not the case?

Mr. Johnson. I think the latter part of your question really goes to a policy issue that needs to be taken up with the Treasury Department.

I think there are some valid reasons, again, on the margin for holding to the process that they go through so long as the decision is to finance the Fund through equities rather than through borrowings. But it does provide a mechanism for showing the total amount of resources that the IMF is responsible for, whether they are usable or unusable.

But I think your question is a good one, and it is something that could be discussed with the Treasury Department.

Representative Saxton. I was struck when I looked at the tables at the end of your statement. The IMF, at one point at least, likened their structure to a credit union.

Mr. Johnson. Yes.

Representative Saxton. In other words, if you were a member of the credit union, one would assume that you had a cash position in the credit union. These tables, I believe tables 1, 2, and 3, show the United States, for example, reserve tranche position as a percentage of quota at 46 percent and a number of other countries, including the UK which is at 37 percent and Australia which is at 43 percent.

Then when you move on to table 2, there are a number of other countries that appear with less than 5 percent of reserve tranche position. And then about two-thirds of the way down on page one of table 2, we begin to see a whole number of countries that have no reserve tranche position represented by 0s.

Then when we move on to table 3, all of page two and—well, all of page three, I was going to say, but there are only two on page three—demonstrate quite clearly that there are some 80 or 90 countries that actually have no reserve tranche position.

Mr. Johnson. That is correct. Table 3 represents the borrowing countries that have already withdrawn their reserve tranche and have called on resources outside of their reserve tranche.

Representative Saxton. Mr. Johnson, of the total amount contributed in excess of 25 percent of member quota in usable resources, what percent is contributed by the U.S., Japan, Germany, and France combined?

Mr. Johnson. Do you have that number?

I believe all of the G-10 is 77 percent, but—yes. I don't think we had added up the percentage for those five countries that you mentioned, but they contributed about 75 percent.

Representative Saxton. So it is clear that the industrialized countries provide better than three quarters of the total assets.

Mr. Johnson. Yes. I think it has become—the institution and how it functions has evolved over the years. In recent years, there has become a much greater distinction between the providers of capital and the users of capital. Clearly, the industrial countries are the providers. They have not drawn even on their own reserve tranche for a number of years. I believe the last drawing was in 1988. So there has been an evolution in the way the Fund operates. That is fairly clear in looking at the numbers.

Representative Saxton. On another closely-related subject, what is the current rate of interest that the United States has paid on its IMF contribution?

Mr. Johnson. I am going to ask Gary—

Mr. Engel. The rate that who is paying? The United States?

Representative Saxton. Yes.

Mr. Engel. Well, basically, for the United States to lend the money to be used by the members, they have to borrow from the public. For 1998, those rates ranged from, if it is a short-term borrowing, which are Treasury bills, about 5 percent and to the mid-term, which are notes, 6 percent, and for the long-term securities, those were about 8.5 percent.

Representative Saxton. Are you saying that the IMF pays those interest rates?

Mr. Engel. No. Maybe I misunderstood. That is what it cost the United States to lend the money to be used.

Representative Saxton. Okay. That was my second question.

My first question was, what is the rate that the IMF pays the United States for our contribution?

Mr. Engel. The remuneration rate for 1998 was about 4 percent. I believe that was before burden-sharing adjustments.

Representative Saxton. So if the United States were to borrow the money which we would then contribute to the IMF, we would then pay, as you noted, anywhere from just under 6 percent to 8 percent; is that correct?

Mr. Engel. Yes. If the money that we borrowed was through long-term lending, it would be more in the 8 percent range. I think generally it is more in the 6 percent range. So it is about a 2 percent difference.

Representative Saxton. Then the IMF pays us an interest rate of about half that 8 percent?

Mr. Engel. Yes, 4 percent for 1998.

Representative Saxton. One could make the case that the United States' taxpayers are subsidizing the IMF with low interest rates; is that correct?

Mr. Engel. There is an interest difference, yes.

Representative Saxton. Regardless of rationale used by the IMF, the IMF interest rate paid to the Treasury is far below the rate—the Treasury cost of borrowed funds, is the point that I am trying to make; is that correct?

Mr. Engel. Yes.

Representative Saxton. The JEC has concluded that the United States' gold contribution as of 1996 amounted to about 1.675 billion SDRs. The IMF has a complicated formula one can use to come to this conclusion or one can just take 25 percent of the total 1975 U.S. quota. That would amount to $2.2 billion, would it not?

Mr. Engel. Yes.

Ms. Anderson. Yes.

Representative Saxton. Thank you.

Let me just say here that it seems to be clear from the data that the United States is the single largest source of IMF funds by far. Not only is the IMF quota relatively high, but the United States consistently contributes a larger portion of its usable funds as well as a higher proportion of the excess reserve contributions that go far above the minimum contributions. These resources are provided to the IMF in return for an interest rate that is far below the Treasury's cost of funds, thereby demonstrating a significant subsidy at taxpayer expense. The size of this subsidy appears to amount to hundreds of million dollars annually. I think that that is something that everyone should understand.

Let me ask about remunerated reserve, the nonremunerated reserve position. The IMF's Treasury booklet talks at length about a position— a portion of the member's reserve position on which the member receives interest but doesn't directly address the portion of which interest is not paid. Is there a portion of our contribution that does not receive interest, a nonremunerated reserve position?

Ms. Anderson. Yes, there is.

Representative Saxton. Doesn't this equal about $2.2 billion?

Ms. Anderson. That is correct.

Representative Saxton. Why doesn't the United States receive interest on this portion of the contribution?

Ms. Anderson. The $2.2 billion represents in U.S. dollars what the initial gold reserve tranche contribution was to the IMF, the U.S.'s share in 1978. The IMF's policy is that since gold is a noninterest-bearing asset, meaning it doesn't make any money off its gold, then it believes that it should not pay its members for the initial amount of the gold that they contributed.

Representative Saxton. So the IMF position is that, inasmuch as we have $2.2 billion worth of gold, it is their position not to pay interest on that value; is that correct?

Ms. Anderson. That is correct.

Representative Saxton. Isn't the IMF justification on this issue contradictory? On the one hand, the IMF would argue that the United States should not receive interest on this portion of its reserve because it reflects the gold portion, which cannot be used to generate interest according to IMF policy. But, on the other hand, the IMF turns around and argues that the gold belongs to the IMF.

If the gold tranche belongs to the IMF and not to the United States, then the United States' reserve position does not contain any gold and should be fully remunerated, should it not?

Mr. Johnson. One could make that argument.

The way that transaction worked when the amendments to the Articles of Agreement were passed in 1978 was that the gold, as you stated, stayed with the Fund, but SDRs were substituted in the accounts in place of the gold. Now, one could argue that the SDRs do earn interest and therefore should be paid. Again, those are policy issues that need to be taken up with the Executive Branch. We wouldn't necessarily have a position on that policy.

Representative Saxton. I understand. But isn't it true that the IMF position is that the gold tranche belongs to the IMF and not to the U.S.?

Mr. Johnson. That is correct, yes. At least that is the IMF's interpretation, and the Treasury Department has not disputed that. We have had that discussion with Treasury, and they essentially agree with that position.

Representative Saxton. Thank you.

Well, setting aside any IMF rationalizations for this treatment, what is the cumulative value of the lost interest payments on this $2.2 billion from 1975 to 1999? In other words, we have not received—whether we argue that the United States owns the gold or that the IMF owns the gold, we have not received any interest payments. What is the cumulative loss to U.S. taxpayers?

Ms. Anderson. We actually have the number as of 1980 through 1999. That number is about $3 billion. So it would be a little over—about $3.5 billion.

Representative Saxton. $3.5 billion?

Ms. Anderson. Yes, of interest that we have not received because of the—our remunerated portion of the reserve tranche.

Representative Saxton. Let me just say here, in addition to the subsidy mentioned before, there is a portion of the U.S. reserve position totaling over $2 billion in which the IMF pays no interest. The cumulative value of this subsidy at the expense of the taxpayers has been estimated, as you just said, in the billions. You estimate $3.5 billion from 1980 to 1995, and of course the gold has been there since 1975.

Mr. Johnson. The gold essentially accumulated over a period of years prior to 1974 when the initial tranche was paid in gold. And there were some—it was a progression. It wasn't all paid in at one time but through that period of time.

Representative Saxton. Thank you.

I would like to just move onto one other set of issues involving gold. Under the gold restitution formula in the IMF articles, eventual restitution would return about 23 percent of the total gold sold under this provision to the U.S., would it not?

Mr. Johnson. That is correct, yes.

Representative Saxton. In your statement you say that the market value of gold is about $26 billion as of this year. Although I do not favor any form of IMF gold sales in the foreseeable future, I would like to ask a question based on the market value cited in your statement. If 10 percent of the IMF gold were restituted, that is 10 million ounces, it would be worth about $2.6 billion. Under the restitution formula this suggests that the United States' net gain would be about half a billion dollars; is that correct?

Mr. Johnson. I believe that is correct.

Do you have those numbers, Tom, for us?

Ms. Anderson. For 10 million ounces?

Representative Saxton. Yes.

Ms. Anderson. That is true, yes.

Representative Saxton. About $500 million?

Ms. Anderson. Yes.

Representative Saxton. I think it is also valid to think of the implications of any precedent that could be construed as giving up potential U.S. gains on the gold over the long-run, especially since the United States' stakes are quite large. Viewed from the perspective of the restitution provisions, wouldn't the U.S. share of the IMF gold be viewed as $4.7 billion net of purchase cost? In other words, does this figure seem about right to you? No one is advocating liquidating all of the IMF gold, but isn't it useful to consider the fact that the United States has a considerable stake in the potential outcome of different types of gold sales?

Mr. Johnson. Yes. I think that is the right number.

If the gold were restituted, of course, that would presume then that the gold would be sold at market, which does fluctuate from time to time, basically on a daily basis, right now. So the amount of profit would vary. But even if the gold were restituted to the members under the formula outlined in the Articles of Agreement, it doesn't necessarily mean that the governments that receive that gold, including our government, would make a decision to put that gold on the market.

Representative Saxton. In your statement you have included an illustration of the proposed distribution which is a very general type of illustration. Has the Administration or the IMF given you any clues about the specific components of their proposal?

Among the questions that arise are the following:

First, what is the proposed schedule of gold sales and what specific criteria is it based on?

Second, how much interest would be available in each of the first three years for debt restructuring?

Third, how does the amount of proceeds that the IMF would receive from the capital value of the gold sales compare with the total interest generated for debt restructuring in the first three years? It appears that, over this time span, the IMF could receive more from the gold sales than is generated from interest or for debt restructuring.

Fourth, when the securities generating the interest mature, exactly where will the proceeds go? Where will the IMF—will these proceeds actually end up?

Mr. Melito. The IMF board discussed this issue last week. It is a nonpublic paper, but some of it was in the press.

They are debating the modalities right now, which methods for selling the gold. The issues include using the central banks or going directly to the market themselves through auction. The interest charge they get from this, again, is not public, but the things they have discussed are basically purchases of sovereign debt instruments. I think they expect a 5 percent or so interest rate.

We don't have the analysis right now about what their projected income would be from this. That would be something that we want to look at closer.

They are projecting, I do know, a stream of revenues over a couple of decades. That is their notion, having the profits generate interest over an 18- or 20-year period. But I don't have available a public number of how much that would generate.

As far as what happens to the actual trust fund at the end of that 18-year period, we have only had a discussion with Treasury about that. Treasury's understanding is the current thinking—it is just that, thinking on it—would be for that money to go to the General Resources Account at the end of that period. I would expect that would have to be written into whatever rules they have, and I'm not sure that has been worked out yet.

Representative Saxton. Did you get any specific numbers either from the Administration or the IMF?

Mr. Melito. There is a nonpublic document which discusses some of these numbers, but we are not at liberty to discuss that at this point.

Representative Saxton. Did they give you any specifics at all?

Mr. Melito. There are specifics on what they think the stream of interest earnings would be over this 18-year period in that document. There is also a discussion of the benefits, the advantages and disadvantages of certain methods of disposing of the gold discussed in that paper as well.

Representative Saxton. Do you think those numbers should be disclosed to Congress?

Mr. Melito. That is up to the Administration and Treasury.

Representative Saxton. Mr. Johnson, Webster's dictionary defines the term "restitution" as follows: "a giving back to the rightful owner of something that has been lost or taken away; restoration." The term "restitution" is the IMF's own description of its procedure for return of gold to donor nations, not mine. If the IMF really believes all of the value of the gold belongs to the IMF, why would it adopt the term restitution for the return of gold to member nations? The IMF is noted for unclear and confusing terminology. Why would it choose such a clear, unambiguous term as "restitution" unless the actual situation is somewhat more ambiguous and complicated than they are maintaining?

Mr. Johnson. I am not actually sure where they came up with that terminology, but basically all that means is they are going to sell the gold back to the members that provided it in the first place and would sell it at a rate of 35 SDRs per ounce.

Representative Saxton. Let me suggest that the explanation that there wasn't a unified point of view on this issue when the IMF charter was amended in 1978 and the point of view that much of the gold value belonged to the member nations was reflected in the use of the term "restitution" and the procedure itself.

Mr. Johnson. There was a debate about that. That is correct.

Representative Saxton. Let me just say at this point—and then we are going to turn to Mr. Watt for whatever questions or comments he may have—there is a strong argument for considering the market value of gold in excess of the official price, which is equal to $47 per ounce, to be the property of the original donor countries.

Regardless of the legal issue, however, it is clear that the use of the IMF restitution formula would return about 23 percent of the gold to the United States with the United States netting about $180 million for every billion dollars in total gold sales through restitution.

This approach also suggests that the United States' share of the IMF gold holdings amounts to about or at least $4 billion. While I am not suggesting an IMF gold sale and think that gold should be held as a long lost reserve, it is useful to consider the implications of the restitution in analyzing potential United States' cost of benefits. If the gold sales are conducted in some other manner, then the United States would lose $180 million per billion in sales of potential restitution. This precedent could convincingly jeopardize U.S. claims on $4 billion in IMF gold holdings.

I want to thank Mr. Watt for his patience here. I am sorry that that took so long, but I wanted to wade through all of that to get it on the record. Sir, the floor is yours.

Representative Watt. Thank you, Mr. Chairman. I appreciate your allowing time for a few questions.

Mr. Johnson, I am going to talk some about the gold sale issue. That is on page 12 of your testimony, your printed testimony.

There is a section that indicates that the U.S. Congress must approve a U.S. Executive Director vote in favor of the Fund's sale of gold in certain circumstances, and then there is a footnote that suggests that those certain circumstances deal with cases in which 25 million ounces of gold are being sold. Then I think the proposal that is being discussed is to sell 10 million ounces; is that correct?

Mr. Johnson. That is correct. The reference in the footnote has to do with the sale that occurred from 1976 through 1980. And the requirement in the law is that the Congress must approve a vote by the Executive Director in favor of selling gold to set up a trust fund in addition to the amounts that were sold during that period of time.

Representative Watt. So it is not actually a 25 million ounce—

Mr. Johnson. No. That has taken place already. The current proposal is 10 million ounces of gold. That would require legislative action to authorize the Executive Director to vote in favor of that. And as you know—

Representative Watt. You are saying it would or would not?

Mr. Johnson. It would.

Representative Watt. So that was the question that I wanted to get to. Is it the IMF's position that it would require—or it is our position—

Mr. Johnson. It is our position that it would require, yes. Because it requires an 85 percent vote to authorize such a sale, the United States could block that sale if such an approval was not forthcoming.

Representative Watt. Okay. Now, what is it that triggers that congressional approval, the establishment of a separate trust fund?

Mr. Johnson. A bill would have to be introduced. I understand that a bill has been introduced in the House Banking Committee that would authorize the Executive Director to vote in favor of a sale. Of course, there are other bills that have—

Representative Watt. That is not my question. My question is, what is it that triggers that requirement about this particular sale? What is it that triggers compliance with that?

Mr. Melito. Most sales of gold require the 85 percent vote of approval. The reason it says "certain circumstances" is because Treasury pointed out to us in the review phase of this testimony that there are a couple of very technical forms of gold sale which are not on the table right now which may not require congressional approval. All of the kinds of gold sale which have been recently discussed would require—

Representative Watt. So that is not an issue then?

Mr. Melito. No.

Representative Watt. Let me move to the next question, then.

On page 13 of your testimony, Mr. Johnson, in the first or second full paragraph, I guess, you indicate that the G-7 has endorsed this proposed sale. Would you talk a little bit about the circumstances under which that endorsement came and in what form it came?

Mr. Johnson. Yes. I would like Tom Melito to discuss that. He has been following the issue of the HIPC proposal for some period of time.

Mr. Melito. As part of the G-7 communique from Cologne, they endorse an expansion of the HIPC debt relief initiative. In that communique they also talk about financing of this initiative in certain respects. They endorse gold sales as one mechanism to help finance the IMF's share of the expanded HIPC.

Representative Watt. How did that endorsement take place?

Mr. Melito. The board of the IMF is composed of the member countries. The G-7, as was pointed out earlier, represent a large voting share of the IMF board. That would be an important part of gathering the 85 percent approval.

Representative Watt. So except for the technicalities of getting congressional approval, this is a done deal, I take it?

Mr. Melito. It is still an open policy issue. It is the Administration that has approved it, not the Congress.

Representative Watt. But aside from that, the country, the Executive Branch is on record in support of this?

Mr. Melito. The Executive Branch working through the House Banking Committee has introduced legislation for this.

Representative Watt. Walk me through, if you would, how the sale would translate itself into debt relief.

Mr. Melito. The gold would be sold at market value one way or the other—

Representative Watt. You might want to make reference to the chart on page 13. I am having a little trouble here figuring out how this actually and ultimately translates into debt relief.

Mr. Melito. I will refer to this as the left column, middle column, and right column. In the middle column, the first box, the first part of the sale—there are a number of different ways of approaching that—we don't really have any analysis on how they do it, but assume the gold is sold. The gold would then produce—revenue from the gold sale. This revenue is then divided into several components. The capital value of the gold, which is basically the amount which the IMF carries on its balance sheet, would go to the General Resource Account. The General Resource Account would have its liquid resources increased by this amount of money.

Representative Watt. Can you put a dollar figure on that?

Mr. Melito. It is $47 an ounce for 10 million ounces. It is about $500 million for the 10 million ounce sale.

Representative Watt. So $500 million goes to the left and—

Mr. Melito. Yes—so the balance sheet of the IMF would not be affected. It would be transferring gold into a liquid resource. The profits from the gold sale, which is everything except the $47 an ounce and—

Representative Watt. The approximate dollar amount for that would be—

Mr. Melito. It depends on the market value of gold. Currently, at 260, we are talking about $230 an ounce. So $2.3 billion or so. It is a very variable market right now. You can't get very precise about it.

The profits would be placed in the ESAF HIPC trust fund. This amount of money in the ESAF HIPC trust fund would then be invested.

As I mentioned earlier, we are not sure exactly what investment instruments they are discussing, but in general the kinds of things they talk about would be sovereign debt instruments which earn around five percent interest rates, maybe some higher and some lower. It is the income generated from those investments which would be basically used to fund the HIPC as well as funding the shortfall in the ESAF. These are the two purposes for that fund.

Representative Watt. Has there been any discussion about exactly what countries would benefit from the debt relief? I mean, what form would that debt relief take?

Mr. Melito. The HIPC initiative is a multi-lateral and bilateral effort. The rules of the initiative use income levels of countries and their debt burdens as measured against certain statistics like export levels. Currently, about 41 countries are potentially eligible for HIPC. Under the Cologne initiative, they have projected about 33 countries would receive debt relief. For these 33 countries, debt relief is expected to be about $27.4 billion. Out of that $27.4 billion, IMF's share is $2.3 billion.

The way that they provide debt relief varies by creditor. Some creditors will actually just remove the debt burden on the day that the debt is forgiven. Other creditors will pay off debt service as it comes due. Other creditors may give new debt at lower interest rates, a refinancing of it. It is really up to the creditor to decide how to provide the debt relief.

Mr. Johnson. I think it should be noted that in the case of IMF they do not forgive debt. So their process would be to help with the servicing of the debt rather than actual outright forgiveness.

Mr. Melito. That is correct. The IMF's likely approach to debt relief would be to pay debt service as it comes due. Over the 10 years of an ESAF loan, as the debt payments come due, IMF's likely approach would be to pay the debt service, as it comes using resources in the ESAF HIPC trust fund.

Representative Watt. If I follow through on everything you have told me—and correct me if I am wrong—you have about $260 billion—what is it, 260—

Mr. Melito. $2.6 billion from 10 million ounces? Yes. At $260 an ounce, 10 million ounces would be roughly $2.6 billion, and about $500 billion of that goes to the General Resource Account. So approximately $2.1 billion would be the profits from the gold sales. But the profits from the gold sales are not what actually is going to fund debt relief. It is interest on those profits.

Representative Watt. I think that is what I am getting to. In the final analysis, the bottom line that actually goes to debt relief is the interest from that part which turns out to be what amount?

Mr. Melito. That number is actually not available publicly at this point.

I would like to add, though, that the gold sale is not the only method of funding IMF's portion. In the Cologne initiative they discussed other methods, which include direct bilateral contributions. They talked about using the special contingency account which was created after the Latin debt crisis but no longer has a purpose. They also mention the possibility of using what are considered premium interest rates, which is the interest rates coming from the SRF (Supplemental Reserve Facility), the facility they used to support Brazil and Russia and Korea recently to help fund the HIPC.

Representative Watt. Do I understand this would trigger—this part of IMF involvement would trigger other debt relief?

Mr. Melito. The HIPC initiative is a joint effort by all creditors. So they all agree to a level of debt relief for a particular country. They then have to fund their own share of it. Once they target the amount of relief for a country, then it is an exercise, by going through the actual debt of the country to figure out what each creditor's share of the debt relief is.

Representative Watt. Did I hear correctly that that would be in a ratio of about 10 to 1?

Mr. Melito. The 10 to 1 you are referring to is how the U.S. scores its own debt relief to very poor countries. The U.S. has about $6 billion worth of debt to the HIPC countries. Secretary Geithner in a hearing two or three weeks ago—

Representative Watt. I thought I heard the figures in the final analysis, you got to the bottom line, you got to 27.4 versus 2.3.

Mr. Melito. That is—the IMF's share of the 27.4 billion is 2.3 billion.

Representative Watt. So it would be about 10 to 1.

Mr. Melito. A little less than 10 percent.

Representative Watt. Thank you, Mr. Chairman. I just wanted to get a better understanding of this.

I understand the Chairman's position is that this shouldn't be done at all. I know it is a controversial issue, but it helps to understand what the impact is in the final analysis.

I yield back.

Representative Saxton. Thank you for your very thoughtful questions.

Let me just emphasize here that the one question that Mr. Watt brought up that I think is very interesting to which Mr. Melito said the figure is not available, if a little better than $2 billion were invested and if a reasonable person said that it should have a reasonable rate of return of, say, 6 percent, that would translate into about $120 million a year return on that investment. And so the gold sales with its advantages and disadvantages ends up throwing off about $120 million for debt relief, which may or may not be considered a lot of money, particularly in light of the fact that it might be compared to the $500 million that IMF is permitted under their proposal to keep for their own purposes. So the figure may not be officially available, but I think reasonable people could conclude that a little over $100 million, $120 million would be about right.

Mr. Johnson. It seems like a reasonable calculation, right.

Representative Saxton. Thank you.

Mr. Ryan.

Representative Ryan. Thank you. Thank you for coming today. I wanted to go down the same road that my colleague, Mr. Watt, went down. I would like to ask you about—Congress does have to approve the gold sale; is that not correct?

Mr. Johnson. The Congress must approve the Executive Director's vote in favor. So, in essence, that is correct.

Representative Ryan. Under the restitution charter, the sale, the IMF would have to pay 23 percent of the sale to the U.S.; is that correct?

Mr. Johnson. No. If restitution occurred, that would encompass the entire amount of whatever gold was offered.

There are different ways to conduct the sale of gold. One would be restitution, which is essentially a sale to the member countries. If gold were sold under the proposal that the Administration has made, then the proceeds of that sale would be allocated according to the method that Mr. Melito discussed. There would be no restitution under that process.

Representative Ryan. So if the Administration was proposing to do it under restitution by selling it back to the member countries, then the 23 percent rule would kick in?

Mr. Johnson. That would be the formula.

Representative Ryan. The United States would collect about $180 million per billion of sales?

Ms. Anderson. Yes. If the restitution of the whole 24 million ounces were made, we would get—about $5.1 billion would be returned to us in gold.

Representative Ryan. So under the current proposal for gold sales we would receive what, about $470 million from restitution? What would that number be?

Mr. Melito. The current plan has no restitution component.

Representative Ryan. I know. But looking at the numbers—

Mr. Melito. Under 10 million ounces, it would be approximately 2.4 million of those ounces. If you would restitute, 10 million ounces would be for the U.S. My colleague will give you the dollar value right now.

Representative Ryan. I am glad somebody brought a calculator.

Ms. Anderson. It would be about the $5 billion that was mentioned earlier.

Representative Ryan. Okay. So under restitution, which I know the Administration is not proposing restitution, that would mean that the U.S. would have to collect about half a billion dollars under this sale if they wanted restitution. This is something that I think—most Members of Congress don't have any idea how this works. It is a very complicated issue. If the IMF were going down the restitution road, that would be something where the U.S. taxpayer would be owed about half a billion dollars under this current proposal?

Mr. Johnson. For the 10 million ounces, correct.

Representative Ryan. That is something very important and worth noting, that the route that the Administration has chosen is to sidetrack the restitution route, which means the IMF would not have to pay the U.S. taxpayer $500 million approximately; is that correct?

Mr. Johnson. It is correct. I don't know that I would characterize it quite like that. They have decided that gold is a way to raise money for the debt relief program that has been adopted. Gold would be one source of revenue for that.

Representative Ryan. So the sale would take place on the open market, correct?

Mr. Johnson. Well, I don't think they have gotten to the point of deciding how the sale would occur. In fact, I don't believe that that decision would be made until the fall general meeting in September. But they have discussed four or five different modalities of sale. Auction on the open market would be one. A direct arrangement with central banks could be another. Using a bullion bank to conduct the sale would be another. There are various modalities that have been discussed, but they have only gotten to the discussion stage. There have been no decisions made that I am aware of on that.

Representative Ryan. Ms. Anderson, did you want to make a comment?

Ms. Anderson. I just wanted to say that if gold were restituted back to the United States, the United States would get gold back.

Representative Ryan. But that is not a modality that is being considered right now by the Administration. So the cost of that decision of not considering modality is roughly—I think it was about $500 million—

Mr. Melito. Let me clarify that. If gold is restituted to the United States, the U.S. Government would owe the IMF about $500 million. The U.S. have to pay the IMF at the official rate of gold. We would be receiving gold worth the market value, so—

Representative Ryan. Because of the difference between the 47, right.

Mr. Johnson. And, again, the profit would assume the sale of gold by the United States after it receives it. But in terms of value, you are correct.

Representative Ryan. I think that is a very interesting point because most members don't know what is at stake here.

Going down the road of the chart that Melvin brought out, under the ESAF agreement, how would you characterize the way ESAF would change if this plan is to go through? Would this be a case where there would be more of a permanent funding mechanism after they get the proceeds of the gold sale into the special disbursement account and is this something that, if we are kind of agreeing on the back of the envelope, that this is going to reap about $120 million a year on something like a 6 percent rate of return? Would this not provide more of a permanent funding mechanism for ESAF?

Mr. Johnson. I believe that is correct. I would like Tom to talk about that a little more. He has done some preliminary calculations on that issue that I think would be helpful.

Mr. Melito. The trust fund that the IMF is setting up has two purposes. I am not sure this is actually well known. Its first purpose is to fund the IMF's share of HIPC. As I mentioned earlier, about $2.3 billion as projected based on the Cologne initiative. The other goal is to fund the shortfall in ESAF, which is projected to start sometime in the early part of the next decade, in about five years.

We have a preliminary breakdown that separates these costs. There is $2.3 billion for the HIPC. We think, working on IMF documents that are on their web page, that the ESAF shortfall is around $2.7 billion, but that is very preliminary. That results in a total of $5 billion for the two purposes. We know that they are mentioning several different ways of paying for that. Gold sales is one of the ways that we mentioned. They have several other purposes. So they are mixing two goals with several financing mechanisms.

Representative Ryan. Because you don't have all of the numbers, but the practical result at the end of the day is they would have more of a self-financing mechanism in place?

Mr. Melito. That is the goal, to have ESAF be self-financed. ESAF would be self-financed, even without getting this money, sometime at the end of the next decade. There is a temporary shortfall in ESAF that is being projected.

Representative Ryan. What—would this affect Congress in its role in oversight of these two funds?

Mr. Melito. That is a good question. That is not something which we have looked at, but clearly it becomes an issue under the current arrangement they have to periodically go to Congress for funding in one way or another such as the sale of gold.

Representative Ryan. We would have to do that then once—

Mr. Melito. That could be a potential implication. Again, we have not done analysis on that.

Representative Ryan. I am a member of the Banking Committee as well as the Joint Economic Committee, which I thank the Chairman for allowing me to sit on the Committee. That is the conclusion that many us in the Banking Committee have made, is that under this proposal this is one way, for a good reason or bad reason, to sidestep annual congressional oversight or review or approval of these funds.

I would just like to let my colleagues know that yesterday I sent a letter to Chairman Leach on the Banking Committee signed by 13 of my Banking Committee colleagues opposing IMF gold sales. In the letter—I will just read a quick quote here. "We urge the Chairman to join us in ensuring that no provision for this gold sale is included in either the FY 2000 authorization request for the international financial institutions or in any other legislation pending before the Banking Committee."

This from a legislative track comes through in a few forms, under the authorization bill, under a debt relief bill. But many members of the Banking Committee, and this is just from the majority side of the Banking Committee, are steadfastly opposed to voting and approving this gold sale in the Committee. Under these very reasons, we don't know the specific modality. It is very clear that under either modality that they chose that we would lose oversight over the IMF, over IMF policies, over ESAF.

Mr. Johnson. That would be a possibility.

Representative Ryan. That is the possibility that seems to be of concern to many Members of the Committee. I think earlier we clearly discovered that there is a significant taxpayer subsidy that currently takes place because of the interest rate disparities with respect to the IMF. That is something that cannot be refuted, correct?

Mr. Johnson. Well, the taxpayer subsidy that you are referring to has to do with the General Resources Account more so than the ESAF. ESAF is very concessional.

Representative Ryan. Right. One of the things that we are concerned about in the Committee, and then I will go on to general IMF policy, is that fact that many Members of Congress have concern that while watching for the constituents dollars, making sure that taxpayer dollars are spent wisely, we are not doing good things. We are going down roads with IMF that many Members of Congress would not like to pursue, doing more harm than good in many of these cases.

Just to summarize, is it your opinion—and I just want to recap this real quickly—that on a restitution, $180 million would have to be returned per billion dollar of sales? Now that the modalities they are considering are nonrestitution modalities, this would be a funding mechanism that would avoid restitution and it would be a funding mechanism that would put more permanent funding for the ESAF in the time being, thereby obviating any congressional oversight or approval in the meantime; is that correct?

Mr. Johnson. I would agree with that.

Representative Ryan. Thank you very much, appreciate it.

Representative Saxton. Thank you, Mr. Ryan.

Mr. Sanford.

Representative Sanford. I just have a couple of general questions.

I think that we have plowed through the ground very well on the issue of transparency and the financial structure of the IMF. Then I want to go from the microscope where we have been just to sort of the big picture. The big picture for me would be if you-all were to think of, let's say, the safest IMF investment, if you want to call it that, what would that be?

Mr. Johnson. I am sorry—

Representative Sanford. In terms of countries, what would be the safest IMF investment?

Mr. Johnson. I think there are probably some risks involved anytime the IMF provides funds for a country that is in crisis. It seems like the Asian countries are coming back so those funds will be returned.

One thing that we have observed in our analysis is that there has been a much greater concentration of funds going to fewer and fewer countries. For example, Russia has about 21 percent, I believe, now of the IMF resources.

Representative Sanford. So would you reverse it and say that Russia would be the worst IMF investment?

Mr. Johnson. Well, the riskiest.

Representative Sanford. I am saying, in terms of creditworthiness, if you had just a pendulum, just the back of the envelope kind of way, you would say that Russia might be toward the less creditworthy end of the scale and some country—this Southeast Asia might be on the upper end of the scale?

Mr. Johnson. That would seem roughly reasonable. It should be noted that when IMF makes its decisions it attempts at least to treat all countries the same and does not do a credit risk analysis.

Representative Sanford. I understand that. But in other words, given the cost of capital to these countries with the exception of a small category, broadly the rate setting is within a relatively narrow band, correct?

Mr. Johnson. Essentially the same.

Representative Sanford. Right. So what I am getting at is, given one country may be over here on the creditworthiness scale and the other country may be over here, there is no adjustment to the cost of capital, to wait and see what private markets. What I am struggling with is, therefore, is the IMF indirectly subsidizing bad policy?

Mr. Johnson. Well, the latter part of your question, I am not in a position to answer.

Representative Sanford. Again, you understand the point that I am making. If you were Lloyds of London there would be a direct credit risk premium.

Mr. Johnson. That is correct.

Representative Sanford. And therefore, since there isn't in this arrangement, in an indirect way, since we make it easier for capital to flow to a place that may have basket case policy, in other words, does it indirectly subsidize the continuation of bad policy?

Mr. Johnson. That may be one way to view it. The other way to view it is that the IMF places some fairly stringent conditions on countries to help them with their macro-economic situation, whatever that may be. And—

Representative Sanford. So in other words you would characterize it, in essence, as an aid program?

Mr. Johnson. Well, it is a program to help countries restructure their macro-economic policies so that they recover from the situation that they find themselves in.

Representative Sanford. Right. I went to credit school up in New York, the Chemical Bank training school, when I was straight out of college. I remember the 5 Cs of credit. What you are saying is basically IMF does not apply the 5 Cs. Rather than adjust in terms of premium based on the riskiness of that given investment, there isn't that adjustment. So one could legitimately make the argument that the IMF subsidizes bad policy, or, in reverse, we are not subsidizing but are an aid program to help those countries.

Mr. Johnson. The IMF is trying to correct that bad policy.

Representative Sanford. I guess the only other thought that I would have would be do you think that this aid program or these costs to the taxpayers ought to be built into the budget? Again, which is outside of your direct role, but in terms of the way we account for our budgeting here in Washington to the United States taxpayer, do you think it ought to be built in?

Mr. Johnson. I am going to ask Gary Engel to respond to that. He is more familiar with the budget.

Mr. Engel. Right now, there is nothing, to my knowledge, built-in to the budget for a subsidy or even for an anticipated default. Under other programs such as credit reform, there is an up-front estimated subsidy, built-in to the cost so that you know what it is costing you to do the program.

Representative Sanford. You think that would be good or do you think that would be bad?

Mr. Engel. I think it would help decision-makers understand what it is really costing to participate in that program.

Representative Sanford. So if you had to pick, your vote would be yes, it ought to be an on-budget item so the taxpayer could see what it cost?

Mr. Engel. Well, as I understand it, it flows through the budget but it is not up front. I personally would be in favor of clearly knowing early on what it is estimated that it is going to cost. Right now what happens is the interest costs are part of a line item in the budget called interest on the Federal debt. So we don't really have an indication of what this difference in interest that we spoke of earlier in the hearing is costing us.

Representative Sanford. I sure appreciate your time. Thank you.

Representative Saxton. Thank you very much, and we appreciate very much again the contribution that you have made here.

Let me just conclude the hearing by saying that certainly, as representatives of the American taxpayers, we have here the obligation to point out several facts that you have been very helpful with. First, that the United States is the single largest source of IMF funds by far, and that the taxpayers of this country are contributors to that. And that these resources that are provided to the IMF in return for an interest rate, which is far below the Treasury's cost of funds, thereby demonstrates further a cost in addition to what we may contributing directly. And that, thirdly, in addition to the subsidy that I just mentioned, there is a portion of the United States reserve position totaling over $2 billion on which the IMF pays no interest whatsoever, accounting for another taxpayer subsidy, if you will. And that, finally, what we are considering in the current context is the sale of a portion of the IMF total gold holdings to which the United States share amounts to almost $5 billion.

And so these are all matters which are of interest to us and of concern to us because of our obligation to the American taxpayer.

We thank you very much for the contribution that you have made. It has been a very important one, and we look toward to working with you as we proceed through these and other issues.

Thank you very much. The hearing is adjourned.

[Whereupon, at 11:23 a.m., the Committee was adjourned.]

SUBMISSIONS FOR THE RECORD

PREPARED STATEMENT OF REPRESENTATIVE JIM SAXTON, VICE CHAIRMAN

It is a pleasure to welcome Mr. Johnson and his colleagues from the General Accounting Office (GAO) before the Joint Economic Committee (JEC) once again. GAO testimony has been an important part of the JEC's program to provide more transparency to the financial structure of the International Monetary Fund (IMF), and we very much appreciate your assistance.

Transparency in IMF finances is needed simply because the IMF is a publicly funded institution in which the U.S. assumes a major financing and policy role. However, IMF financial activities are cloaked in an obscure accounting system designed in an era when the nature of IMF activities was very different from what it is today. Even the public financial statements of the IMF are confusing, as reflected in the inaccurate statements of a member of the IMF executive board before Congress last summer. While confusion about the IMF's public financial statements is quite understandable given their format, another problem is that the operational budget of the IMF is treated as a classified document.

The ongoing JEC review of IMF finances in recent years has involved much effort in seeking more transparency in IMF operations. Unfortunately, our review of IMF operations and promotion of IMF transparency has been hampered by IMF and Treasury refusals to publicly release documents such as the IMF operational budget and policy reviews that would permit consultation with independent experts. It became evident that if significant IMF financial transparency were going to occur, it would have to be directly provided through Congress. This was one factor leading to my request last year for assistance from the GAO in gaining access to IMF financial information.

By forcing additional financial information into the public domain, it was my hope that the activities of the JEC and GAO would result in more transparency and also reduce IMF incentives to withhold information related to that already in the public domain. In one of a series of JEC hearings last year, the GAO presented the first intelligible and reasonably complete overview of IMF finances available up to that time. Subsequently, the IMF has moved to make more of its financial information public, but this institution has a long way to go before it can be considered reasonably transparent. However, progress on other fronts is being made. A recent positive development is the publication of a study on IMF finances by the Bretton Woods Committee which corroborates the conclusions of JEC research in this area in several key respects.

This hearing will focus on information related to costs of U.S. participation in the IMF as reflected in quotas, IMF interest payments to the U.S., potential gold sales and restitution, and budgetary treatment. Although it has not been easy, we now have the necessary analytical tools for uncovering the most relevant financial data so that independent appraisal and analysis of IMF operations can be facilitated. It is important that this information be made publicly available for informed policy analysis regardless of where we stand on the many policy issues related to the IMF. The GAO is making a presentation of factual material, and has not been asked to take a position on any issue currently before the Congress.

An assessment of the costs associated with United States' participation in the IMF suggests that the U.S. bears a disproportionate share of the costs of IMF operations. Further, these costs are often hidden or obscured by various accounting and other means. A review of IMF quotas indicates that the best measure of the U.S. share of IMF contributions is 26 percent, not the 18 percent figure officially circulated. However, it appears that the IMF does not pay the U.S. interest on over $2 billion of its contributions, and the cumulative cost of this to the U.S. in recent decades has been significant. Another cost issue relates to proposed gold sales, which could impose direct costs to the U.S. and also affect a legitimate U.S. claim to several billions of dollars in gold assets. Finally, there is the question of whether the current budgetary treatment of the IMF fully complies with the recommendations in the *Report of the President's Commission on Budget Concepts*.

I would like to thank Mr. Johnson and the GAO team for all their hard work in helping the Congress gain access to IMF information that for too long has neither been publicly available nor easily understandable.

United States General Accounting Office

GAO

Testimony

Before the Joint Economic Committee

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INTERNATIONAL MONETARY FUND

Current Financial Situation

Statement of Harold J. Johnson, Associate Director
National Security and International Affairs Division

and

Gary T. Engel, Associate Director, Accounting and
Information Management Division

GAO

Accountability * Integrity * Reliability

GAO/T-NSIAD/AIMD-99-254

Mr. Chairman and Members of the Committee:

We are pleased to be here today to discuss issues related to the International Monetary Fund's (IMF)[1] financial situation. Our remarks will be based on our past work for this Committee[2] and our ongoing review required by the Omnibus Appropriations Act for fiscal year 1999.[3] The information we will present on our ongoing work is preliminary. We expect to complete our work and report to the congressional committees specified in the law by the end of September. As requested, today we will discuss

- the Fund's current situation regarding quota resources that the IMF obtains from its member countries and that is used for most of its financial assistance;
- the level of resources that the Fund has reported as actually available for lending; and
- other resources that the Fund potentially has available for conducting its operations, such as resources obtained through borrowing and the Fund's gold holdings.

As you requested, we will discuss the IMF's financial situation from both a current and historical perspective, highlighting the share of the IMF's financial resources that have been contributed by the Group of Ten (G-10)[4] countries. Also as requested, we will provide current and historical perspectives on the IMF's gold holdings.

[1] The IMF is an organization of 182 member countries that was established to promote international monetary cooperation and exchange rate stability and to provide short-term lending to member countries that experience balance-of-payments difficulties.

[2] International Monetary Fund: Observations on Its Financial Condition (GAO/T-NSIAD-98-220, July 23, 1998).

[3] The Omnibus Appropriations Act for fiscal year 1999 (P.L. 105-277, Oct. 21, 1998) appropriated about $18 billion for the IMF and required us to report on seven specific matters. We have divided this mandate into three reports: International Monetary Fund: Approach Used to Establish and Monitor Conditions for Financial Assistance (GAO/GGD/NSIAD-99-168, June 22, 1999); International Monetary Fund: Trade Policies of IMF Borrowers (GAO/NSIAD/GGD/99-174, June 22, 1999); and a report on the IMF's financial operations that will be issued by September 30, 1999. The act requires the latter report to include the IMF's current financial condition and certain current and historical information on its lending.

[4] The G-10 comprised 10 industrialized countries: Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, the United Kingdom, and the United States. Switzerland became the 11th member in 1984.

Summary

For the financial year ended April 30, 1999, the IMF had about $287 billion in resources in its General Resources Account (GRA) obtained primarily from members' quota. However, from the GRA IMF could use only about $195 billion, that is, the amount from members that are sufficiently strong economically to permit their currencies to be used for IMF operations. The remaining $92 billion was unusable for lending as it consisted of member currencies in weak positions and gold, which the IMF does not consider to be a liquid resource. Of the usable amount, about $118 billion had been lent, committed, or reserved leaving about $77 billion available for additional credit to IMF members and to meet members drawing on their reserves held by the IMF.

In addition to these resources, the IMF has several other resources potentially available for lending. The IMF's Articles of Agreement permit the Fund to borrow resources for its operations and transactions. The IMF has borrowed from member governments on multiple occasions and maintains two standing arrangements with groups of countries for use when quota resources are insufficient. These arrangements, the General Arrangements to Borrow (GAB) and the New Arrangements to Borrow (NAB), are standing credit lines worth a combined total of about $46 billion. The IMF drew about $6 billion under these arrangements in July 1998 and December 1998 to finance lending to Russia and Brazil but repaid these obligations in March 1999.

As of April 30, 1999, the IMF had about 103 million fine ounces of gold holdings with a market value on that date of about $30 billion.[5] According to IMF's Executive Board, the gold provides an underlying strength to IMF's financial condition, can be used to replenish currency holdings if IMF does not have enough liquid resources to pay creditors, and is available for contingencies. However, gold is a non-interest-earning asset and is not deemed by the IMF to be a liquid resource. In the past, the IMF sold gold for a variety of purposes, most recently during 1976-80 to raise funds to support lending to poorer IMF member countries. In addition, during that same period, IMF restituted gold, that is, sold gold, to the members that had previously used gold to pay part of their quota. The IMF has determined that ownership rights to the Fund's gold clearly reside with the IMF. However, under the Fund's Articles of Agreement, members may have residual rights to the gold in two instances: if the Fund elects to restitute

[5] As of July 14, 1999, the market value of the Fund's gold holdings had declined to about $26 billion.

gold to members or if the Fund is liquidated. In the first instance, gold could be restituted to countries that were members on August 31, 1975, based on their relative quotas at that time. In the case of liquidation, gold may be restituted to members on the same basis after the Fund's liabilities have been satisfied.

Background

Before discussing the details of IMF's financial situation, it is useful to give some background on members' quotas, currency purchases and repurchases, and gold holdings.

Members' Quotas

Quotas are the membership dues that countries pay when they join IMF and when there is an approved increase in such dues. Quotas comprise the bulk of the Fund's resources for providing financial assistance. Up to 25 percent of quotas must normally be paid in reserve assets, which are currencies that are freely usable in the principal foreign exchange markets (U.S. dollars, yen, euros, or the pound sterling) or "special drawing rights" (SDR).[6] The balance may be paid either in a country's domestic currency or with noninterest-bearing promissory notes.[7] The portion paid in freely usable currency, or SDRs, is referred to as the member's reserve assets or initial reserve tranche position. This portion can be drawn by the member as needed based upon the representation of a balance of payments need. If withdrawn, these amounts are to be replaced with the country's own currency; however, members are not obligated to replenish their reserve tranche positions by, for example, repurchasing their own currency with freely usable currency.

Currency Purchases and Repurchases

When a member needs additional funds other than from its reserve tranche position, the country purchases the currency it needs from IMF with an equivalent amount of its own currency. The member later repurchases its

[6] The SDR is a unit of account that IMF has used since 1969 to denominate all its transactions. Its value comprises a weighted average of the values of four currencies: the U.S. dollar, Japanese yen, euros, and pound sterling. Because the value of the SDR relative to the U.S. dollar changes daily, the dollar value of amounts converted from SDRs also changes daily.

[7] These promissory notes are made payable to IMF, are denominated in the member's domestic currency, and are held by the member's designated central bank or other designated depository. IMF views these notes as fully equivalent to its currency holdings because IMF can cash the notes on demand within 24 hours to receive members' domestic currency. IMF members are obligated to maintain the SDR value of their quotas.

own currency using SDRs or other currency on terms established by IMF. Because IMF's financial assistance is in the form of currency purchases by member countries, it does not reduce the combined total of IMF's currency holdings in terms of SDR equivalents; that is, the funds are not lent out.[8] Instead, the composition of IMF's currency holdings changes as "borrowers" replace the currency they purchase with their own currency. The relationship of IMF's holding of a member's own currency to the member's quota is an important one because it determines whether the member is a creditor, debtor, or in a neutral position with IMF. With some exceptions, currencies of members who are creditors are considered usable by IMF to finance transactions, while currencies of countries in a neutral borrowing or a debtor position are considered unusable by IMF. Appendix I lists IMF member countries classified as creditor, neutral, or borrower as of April 30, 1999.

Gold Holdings

The IMF holds about 103 million fine ounces of gold at designated depositories in four member countries.[9] The IMF acquired almost all of its gold prior to January 1, 1974, when its Articles of Agreement required that in most cases 25 percent of members' quota subscriptions be paid in gold and that certain transactions between member countries and the IMF be conducted in gold. In 1978, IMF's Articles of Agreement were amended to reflect the end of the fixed currency exchange rate system that had governed the international financial system up to that time. IMF's Articles specify that based on an 85-percent majority vote of the total voting power of the Executive Board, the IMF may sell its gold on the open market and it may accept gold, at market prices, in discharge of a member's obligations to the Fund.

The IMF values its gold at SDR 35 per ounce (about $47 per ounce as of April 30, 1999), its value at the time of acquisition.[10] Therefore, the IMF's gold holdings are valued on its balance sheet at SDR 3.6 billion (about

[8] The IMF considers its financing to low-income developing countries on concessional (below-market-interest-rate) terms to be lending. This lending is financed from a trust account, the Enhanced Structural Adjustment Facility (ESAF) Trust that is administered by the IMF outside of its General Department.

[9] These gold holdings represented about 9 percent of the world's official gold holdings in March 1999.

[10] An exception is a small amount of gold (21,396 ounces) that Cambodia gave to IMF in December 1992 in partial settlement of an overdue loan obligation. The IMF values this amount at SDR 5.1 million (about $6.8 million currently).

$5 billion). However, the IMF reports in a footnote to its financial statements the market value of its gold holdings as of its financial year-end. On April 30, 1999, the IMF estimated its gold was worth about $30 billion. Were the IMF to sell some of its gold, it is unclear how much money could be raised because the world price fluctuates and might be affected as a result of the sale. In addition, the IMF has stated it does not have legal authority to buy, lease, or swap gold.

Availability of IMF Resources

We will now discuss the resources that are available to the IMF to conduct its operations.

Current Size and Historical Growth of IMF's Quota Resources

In January 1998, IMF Board of Governors[11] approved a new quota[12] level of SDR 212 billion ($288 billion), a 45-percent increase from the prior quota level of about SDR 146 billion. The quota became effective in January 1999 when members having 85 percent of the total quotas consented to the quota increase. As of April 30, 1999, about $5 billion in quotas had not been paid to the IMF by 27 members. Specifically, seven member countries[13] are currently in protracted arrears to the IMF for overdue obligations and are ineligible to consent to or pay their quota increases until they become current on their obligations. In addition, 20 other members[14] have not individually consented to the quota increase and have until July 30, 1999, to do so.

Since the IMF was created in 1945, total quotas have grown substantially. This growth in IMF's quotas came from increased membership, eight quota increases since 1959, and several special and ad hoc increases in quotas of

[11] The Board of Governors is the highest decision-making body of the IMF.

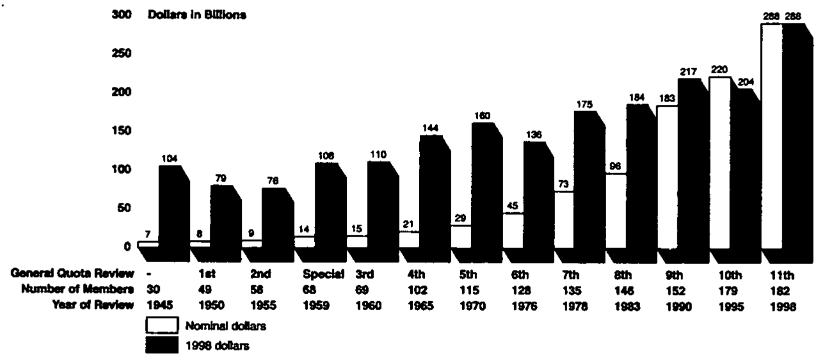
[12] A general quota increase involves all member countries. Quotas of individual members or groups of members may be increased at other times.

[13] The Islamic State of Afghanistan, the Democratic Republic of Congo, Iraq, Liberia, Somalia, Sudan, and the Federal Republic of Yugoslavia (Serbia and Montenegro). The Federal Republic of Yugoslovia has not yet succeeded to the membership of the Socialist Federal Republic, which ceased to be a member in 1992.

[14] The Bahamas, Belgium, Brunei Darussalam, Estonia, Grenada, Guatemala, Haiti, Lao PDR, Lebanon, Luxembourg, the Marshall Islands, Micronesia, Namibia, Nepal, Qatar, St. Vincent and the Grenadines, San Marino, Turkmenistan, United Arab Emirates, and Uruguay.

individual members.[15] During this period as reported by the IMF, the overall general quota increases ranged from about 34 percent to about 61 percent. The United States has historically contributed the largest amount of quota resources. However, the U.S. share of quotas has fallen, from a high of about 39 percent of total quotas in 1945 to the current level of 17.5 percent. The decrease in the U.S. share of quotas is primarily due to the expansion in IMF membership over the years—152 countries have joined the IMF since its founding. However, the absolute size of the U.S. quota has increased, from about $2.8 billion in 1945 to the current amount of about $50 billion.[16] Figure 1 shows the historical growth in IMF quotas in both nominal and inflation-adjusted 1998 dollars. Also shown is the number of IMF members at the time of each quota review.

Figure 1: Approved IMF Quotas at General Reviews, 1945-1998



Note 1: Quota values are expressed in 1998 dollars using the average 1998 dollar/SDR exchange rate and an SDR price deflator. This deflator is constructed from the weighted average inflation rate of

[15] This includes seven general reviews and a 1958/59 special review. The first, second, third, and 10th general reviews resulted in no increases in quotas.

[16] Other countries with large quotas include Japan and Germany (about $18 billion each, or 6 percent of quotas), and France and the United Kingdom ($14.5 billion each, or 5 percent of quotas).

those countries that comprise the SDR basket of currencies. For nominal dollars, we used the annual average dollar/SDR exchange rate. For the period prior to the creation of the SDR in 1969, we used the inflation rate of the United States because the IMF used the U.S. dollar as its unit of account. This methodology is preliminary and will be further developed in our subsequent report.

Note 2: For the 1995 10th General Review, the nominal dollars exceeded 1998 dollars due to a historically high SDR exchange rate.

Source: GAO analysis of IMF data.

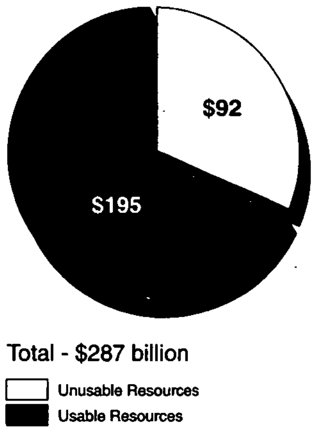
The Fund relies primarily on quota resources to meet credit demands from its members. However, during some periods of great demand for IMF financing, the IMF has borrowed funds from member countries to use for its operations. In December 1978, 62 percent of IMF credit outstanding was funded from resources that IMF had borrowed.

Resources Currently Available for Lending

In July 1998, we testified that about $43 billion of the $201 billion in total resources were available at that time for lending. As of April 30, 1999, about $77 billion of the $287 billion of the IMF's total resources were available for lending. Today, using these updated figures, we will explain the step-by-step process that the IMF uses for making its estimate of resources available for lending.

As before, the IMF begins with its total amount of resources, about $287 billion as of April 30, 1999. Before considering IMF extended credit, about $195 billion, or 68 percent, is usable as indicated in figure 2.

Figure 2: IMF Estimated Usable and Unusable Resources, April 30, 1999



Note: The SDR/U.S. dollar exchange rate was SDR 1= $1.35123.

Source: GAO analysis of IMF data.

These usable resources consist of (1) holdings of currencies of members considered by the Executive Board to have sufficiently strong balance of payments and reserve positions for their currencies to be used in IMF operations and (2) IMF's holdings of SDRs. The remaining $92 billion of resources is considered unusable. These resources cannot be used to finance IMF transactions because they are

- currencies of members that are using IMF resources and are therefore in a weak balance-of- payment or reserve position;
- currencies of members with relatively weak external positions who have drawn on their reserve position but have not borrowed;
- gold holdings of the Fund which require an 85-percent vote by the Executive Board to be used and are not considered by the IMF as liquid assets; or
- other non-liquid assets, such as buildings and facilities.

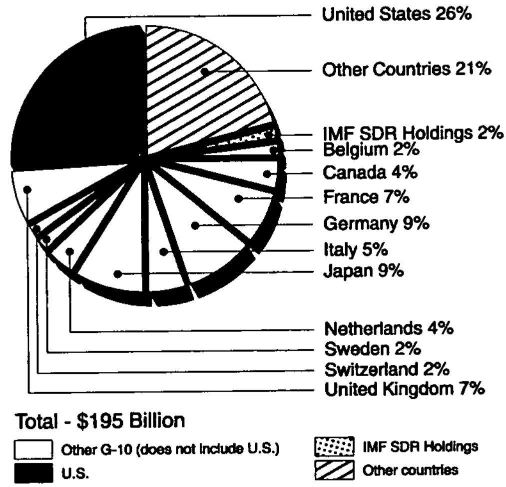
The use of IMF credit by a member generally increases the IMF's unusable resources and reduces its usable resources by equivalent amounts. From December 31, 1988, through April 30, 1999, a minimum of 29 members had currency that the IMF identified as sufficiently strong to be used in IMF operations.[17] The maximum number of countries in this situation during this time period was 39.

Usable Resources of the G-10 and Other IMF Members

Figure 3 shows the percentage of usable resources provided by the G-10 and other IMF members as of April 30, 1999.

[17] The level of usable currencies fluctuates as certain currencies strengthen over time and become part of the operational budget or as countries experience difficulties and thus are no longer included as part of the operational budget. In that instance, the entire stock of that country's currency becomes unusable.

Figure 3: G-10 and Other IMF Members' Usable Resources as of April 30, 1999



Source: GAO analysis of IMF data.

As of April 30, 1999, about 77 percent of the resources the IMF deemed usable were contributions made by the G-10. The United States is the single largest contributor of usable resources with 26 percent of the total. In addition, IMF's holdings of SDRs amounted to about $5 billion that comprised about 2 percent of its usable currencies.[18]

[18] SDRs can be held by, but not allocated to, the General Resources Account of the IMF. The GRA receives SDRs in partial payment of quotas, from charges on the use of IMF resources, and from repurchases.

Available and Uncommitted IMF Resources

As of April 30, 1999, the IMF had $195 billion of usable resources to meet requests for funds and requests for use of creditor members' reserve assets. The IMF takes several steps to calculate its available and uncommitted resources, referred to as liquid resources, as indicated in table 1.

Table 1: IMF Available and Uncommitted (Liquid) Resources as of April 30, 1999

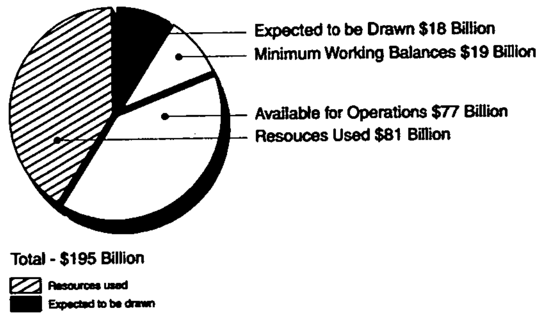
U.S. dollars in billions	
Total usable resources (before IMF extends credit)	$195
Less: Resources used (credit extended)	(81)
Available and usable resources	$114
Less: Commitments	(18)
Less: Minimum working balances	(19)
Available and uncommitted resources	$77

Note: SDR conversion rate = $1.35123.

Source: GAO analysis and IMF data.

First, the IMF reduces its total usable resources of $195 billion by about $81 billion, which is the amount of outstanding credit extended as of April 30, 1999. The IMF then reduces its available and usable resources of $114 billion as of April 30, 1999, by (1) $18 billion of commitments made to countries needing assistance and (2) a minimum working balances reserve of $19 billion, which is the amount IMF officials believe is needed to make payments in specified currencies. IMF's Executive Board set the minimum working balances at 10 percent of the quotas of members in a strong external and reserve position. This leaves about $77 billion available for additional credit to IMF members and to meet members drawing on their reserves held by the IMF. Figure 4 shows a breakdown of IMF's liquid resources as of April 30, 1999.

Figure 4: IMF Liquid Resources as of April 30, 1999



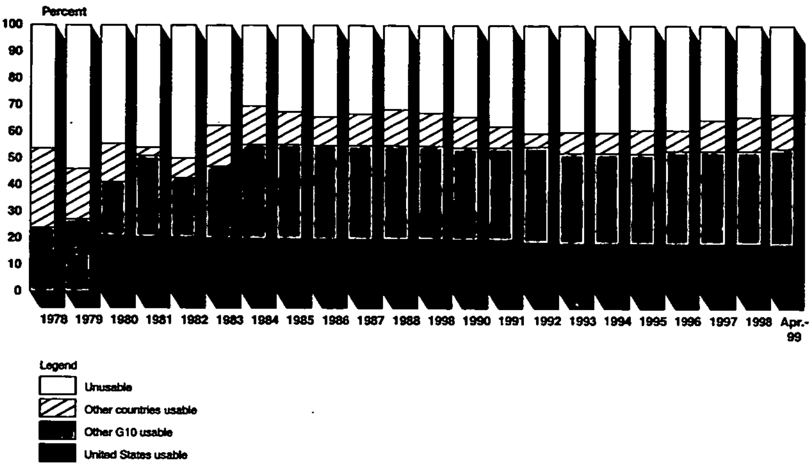
Note: The SDR/U.S. dollar exchange rate was SDR 1= $1.35123.

Source: GAO analysis of IMF data.

Over the past 20 years the amounts of usable and unusable resources have varied. Usable resources over the period averaged about 60 percent of total resources, with a significant portion coming from the G-10. As figure 5 shows, during this period, the United States was the major contributor of usable resources, except during 1978 and 1979 when it was deemed insufficiently strong and was excluded from IMF's operational budgets.[19]

[19] Following the depreciation of the U.S. dollar in the fall of 1978 the United States mobilized resources including $5 billion from the Fund to defend the dollar.

Figure 5: Usable and Unusable Quota Resources, End of Calendar Years 1978-98, and April 30, 1999



Source: GAO analysis of IMF data.

IMF Borrowing

Historically, IMF has borrowed only from official sources to supplement its resources obtained from members' quotas. This includes member countries and their central banks, one country that was not a member at the time the funds were borrowed and its central bank, and the Bank for International Settlements.[20] The Fund has not borrowed from private capital markets, although IMF's Articles of Agreement permit it to do so. According to IMF, the preference for borrowing from official rather than private sources reflects the nature of the Fund as a cooperative,

[20] The Bank for International Settlements is an organization of central banks that is based in Basle, Switzerland. It is the principal forum for consultation, cooperation, and information exchange among central bankers.

intergovernmental institution whose basic purpose is to facilitate the overall adjustment process by using surpluses to assist countries in deficit positions.

The IMF first activated its General Arrangements to Borrow (GAB)[21] credit lines in 1964. In the 1970s during periods of large payment imbalances, borrowed resources financed some 45 to 62 percent of IMF credit between 1974 and 1979 and 40 to 50 percent between 1980 and 1985. According to a U.S. Treasury official, some of the borrowings were necessary to satisfy Reserve Tranche drawings by industrial countries, including the United States. Since 1985, the IMF decreased its borrowing substantially and between 1992 and 1997 did no borrowing.

The IMF resumed borrowing in July 1998, when it borrowed about $2 billion under the GAB to finance credit assistance to Russia. Also, in December 1998, the IMF borrowed about $4 billion from its recently established credit line, the New Arrangements to Borrow (NAB),[22] in connection with a 3-year credit arrangement with Brazil. Both of these amounts were repaid in March 1999, shortly after the IMF received funds from the recent quota increase.

IMF Gold Holdings

IMF policy stresses the importance of gold as a reserve asset for the Fund. In 1995, the IMF's Executive Board reviewed the Fund's position on holding gold as a reserve asset and established several governing principles for managing its gold reserves. These principles state that

- gold provides a "fundamental strength" to the IMF;
- gold provides operational maneuverability in the IMF's use of its resources and adds credibility to its precautionary balances;
- gold should be held to meet unforeseen contingencies;
- the IMF has a responsibility to avoid disruption to the functioning of the gold market; and
- profits from gold sales should be retained and invested and only the income from such investments should be used for agreed upon purposes.

[21] The GAB is an arrangement of credit lines that the IMF maintains with G-10 countries for use in emergencies.

[22] The NAB is an enlarged version of the GAB with 25 members. Together, GAB and NAB had a combined total about $46 billion as of April 30, 1999.

These governing principles reaffirm a long-held belief by the Fund that gold forms a key part of the organization's reserve structure.[23]

IMF Has Sold and Restituted Gold

From 1976 through 1980, the IMF reduced its gold holdings by one-third but has not disposed of any gold since then. Sales of gold on the open market or restitution of gold to the members who contributed it have been used for a variety of purposes

- Sales for replenishments: On several occasions in the late 1950s and in the 1960s, the IMF sold gold to replenish its holdings of usable currencies.
- Sales to offset operating deficits: To generate income to offset operational deficits, the IMF sold gold to the United States and invested the proceeds in U.S. government securities. A significant buildup of reserves through income from charges to members prompted the IMF to reacquire the gold from the U.S. government in the early 1970s.
- Gold auctions: Between April 1976 and May 1980, the IMF disposed of 25 million ounces of gold to finance an IMF trust fund, which was created in 1976 to support concessional lending to low-income countries.
- Restitution of gold to members: Between 1977 and 1980, the IMF restituted a total of 25 million ounces of gold, in four annual installments, to members in proportion to their quota shares as of August 31, 1975. For the United States, this translated into the acquisition of 5.74 million ounces of gold.

According to IMF officials, the proposal for an IMF trust fund to provide balance of payment support to developing countries originated with U.S. officials in late 1974. This proposal coincided with Treasury's desire to diminish gold's role in the international monetary system. As a result, according to the IMF, U.S. Treasury officials proposed the sale of 25 million ounces of the Fund's gold to establish a trust fund to finance balance of payment support to low-income countries. The restitution of an additional 25 million ounces of gold to members was viewed as a necessary incentive for industrialized members to approve the sale of 25 million ounces to

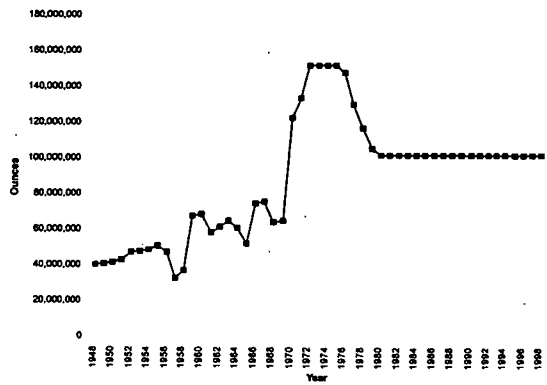
[23] The analytical support for these governing principles is contained in a 1995 nonpublic IMF report. Significantly, this study cites the U.S. Gold Commission report of 1982 as partial justification for the Fund's approach to holding gold as a reserve asset. U.S. Treasury officials confirmed that this 1982 study remains the basis for U.S. gold policy and is similar in many respects to the Fund's policies on gold.

establish the trust fund. The gold sold on the open market netted $5.7 billion in proceeds, of which $1.1 billion was deposited in the GRA as capital value (that is, the value at the price of SDR 35 per ounce). The remaining $4.6 billion was placed in the IMF trust fund for the benefit of developing countries. From this amount, $1.3 billion was distributed to developing countries in proportion to their IMF quotas, and the remaining $3.3 billion was made available for IMF trust fund concessionary lending.[24]

Figure 6 shows changes to the IMF's gold holdings since its inception. The steep rise in gold holdings in the early 1970s was due to the relatively large fifth general quota increase and the reacquisition of gold previously sold to the United States. Under this and earlier quota increases, member countries were generally required to pay up to 25 percent of their quota increase in gold.

[24] As explained by an IMF official, the Executive Board made a key policy decision in 1980 to retain all trust fund repayments for future concessional lending programs. As a result, no loan repayments have been directed to the General Resource Account and no repayments have been forgiven. Subsequent repayments of trust fund loans have been used in different ways. They were used to establish a subsidy account for the Supplementary Financing Facility, to finance all Structural Adjustment Facility operations, and to finance the ESAF reserve account and a small amount of the ESAF subsidy account.

Figure 6: IMF Gold Holdings Since Inception



Source: IMF International Financial Statistics.

Recent Proposals to Sell Some of IMF's Gold

Several proposals have been made in recent years to sell some of the IMF's gold. However, the U.S. Congress must approve a U.S. Executive Director vote in favor of the Fund's sale of gold in certain circumstances.[25] In 1993, the IMF's Board of Governors agreed to, following the approval of the U.S. Congress, the contingent sale of up to 3 million fine ounces of gold to cover ESAF potential loan defaults. The gold would be sold if it were determined that the resources in the ESAF Trust Reserve Account (plus other available means of financing) were insufficient to meet payments to be made from that account to ESAF lenders. The IMF has since deemed it unlikely that

[25] Under U.S. law, the executive branch may not approve IMF dispositions of gold over 25 million ounces benefiting individual IMF member countries or particular segments of the IMF membership unless the Congress by law authorizes the disposition (22 U.S.C. 286c). According to a U.S. Treasury official, because 25 million ounces of gold were sold between 1976 and 1980 for the benefit of a particular segment of IMF membership, any further sale of gold for the benefit of a particular segment of IMF membership requires statutory approval. According to Treasury, congressional approval would not be required if the sale of gold were for restitution or to replenish IMF resources.

such a gold sale will be needed because sufficient balances exist in the ESAF Trust Reserve Account.[26]

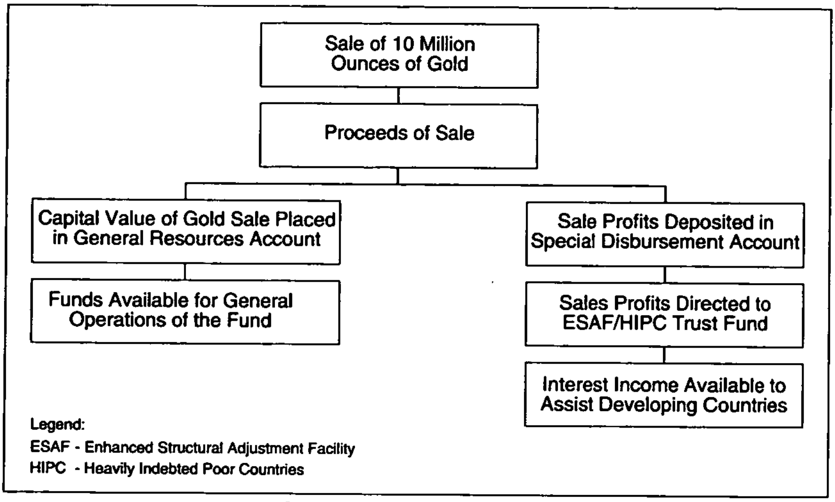
In late 1996, the IMF proposed that if a financing gap remained in the ESAF and Heavily Indebted Poor Countries (HIPC) Debt Initiatives after all efforts had been made to obtain maximum bilateral contributions, the Fund would sell up to 5 million ounces of gold to make up the funding shortfall. According to an October 1996 Congressional Research Service report, the IMF had the requisite votes to adopt this proposal; however, reported opposition by Germany, Switzerland, and Italy led to an indefinite delay.

More recently, the IMF proposed to sell up to 10 million ounces of gold that was endorsed by the G-7[27] at Cologne, Germany, in response to growth in the level of debt relief anticipated for ESAF and HIPC. Figure 7 illustrates the proposed distribution of the gold sales.

[26] Under 22 U.S.C. 286e-1, the Secretary of the Treasury is authorized to instruct the U. S. Executive Director of the IMF to vote to approve the Fund's pledge to sell, if needed, up to 3,000,000 ounces of the Fund's gold, to restore the resources of the reserve account of the ESAF Trust to a level that would be sufficient to meet ESAF obligations.

[27] The G-7 consists of seven major industrialized countries (Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States) that consult on general, economic, and financial matters.

Figure 7: Proposed Distribution of Gold Sales



Source: IMF and the Treasury.

In contrast to the earlier sale of 25 million ounces of gold, the more recent proposals to sell gold earmark the interest on the investment of gold sale profits to help fund the IMF's share of debt relief for poor countries. This approach is consistent with the IMF's 1995 governing policy on gold that capital profits from gold sales should be retained and only the income resulting from the investment of these profits should be used for agreed-upon purposes.

Provisions in IMF's Articles of Agreement Affecting the Sale or Management of Gold

The IMF's Articles of Agreement detail how the IMF may sell gold and use the proceeds from such sales. The Articles specify that based on an 85-percent majority vote of the total voting power of the Executive Board, the IMF may sell gold on the open market and may accept gold, at market prices, in discharge of a member's obligations to the Fund. According to an IMF official, the IMF is not authorized to engage in any other gold transactions—including loans, leases, or use of gold as collateral—because they are not expressly allowed under the IMF's Articles of Agreement. More specifically, IMF documents state that the Articles of Agreement permit only the transfer of ownership rights to the gold for a price. According to IMF officials, because loans, leases, swaps, or the use of gold as collateral do not require a permanent transfer of ownership rights, they are not permitted by the Articles of Agreement. Some central banks have increasingly decided to manage their gold reserves by loaning, leasing, or swapping their gold to earn a small profit. The World Gold Council estimates that 70 central banks currently manage their gold reserves in this manner. Although U.S. law does not preclude the loaning, leasing or swapping of its gold holdings, the United States has chosen only to monetize its gold.[28]

When gold is sold by the IMF, the original capital value of the gold of SDR 35 per fine ounce is deposited in the GRA and becomes immediately available for the general operations of the Fund. Gold sale profits (that is, the sale price above the capital value of the gold) are generally deposited in a separate account called the Special Disbursement Account (SDA), which provides the primary financial framework for handling such profits. Gold sale profits in the SDA may be transferred to specialized accounts (such as the ESAF/HIPC Reserve Trust Account) or they may be transferred to the GRA for use in the Fund's general operations.[29]

Specifically, the Articles of Agreement state that based on majority votes by the Executive Board that assets held in the SDA may be used

- to make transfers to the GRA for immediate use in the Fund's operations (70 percent of total voting power);
- for operations and transactions that are not authorized by other provisions of the articles but are consistent with the purposes of the Fund including balance of payments assistance to developing members (85 percent of total voting power);

[28] The Secretary of the Treasury is authorized to issue gold certificates to the Federal Reserve which issues an equivalent credit (at the official price of gold) to a Treasury deposit account. The 1998 Financial Report of the United States Government notes that $11 billion of the U.S. gold reserve has been monetized in this fashion.

[29] Gold sale profits would be returned to the SDA when the specialized account is closed.

- for proportionate distribution of resources authorized for the purpose of providing balance of payments assistance to those developing members that were members on August 31, 1975, based on their respective quotas on that date (85 percent of total voting power); and
- to transfer SDA resources to the investment account (85 percent of total voting power).[30]

The IMF has determined that ownership rights to the Fund's gold clearly reside with the IMF.[31] Under the Fund's Articles of Agreement, members may have residual rights to the gold in two instances: if the Fund elects to restitute gold to members or if it elects to liquidate the Fund. In the first instance, gold could be restituted to all countries that were members on August 31, 1975, based on their quotas at that time.[32] In the latter case, gold may be restituted to members on the same basis after the Fund's liabilities have been satisfied. If the IMF elected to restitute its current stock of over 100 million ounces of gold, the United States would receive almost 24 million ounces of gold based on the formula described in the Articles.

Mr. Chairman, that concludes our prepared remarks. We would be happy to respond to any questions you or other members of the Committee may have.

Contacts and Acknowledgments

For future contacts regarding this testimony please contact Mr. Harold J. Johnson at (202) 512-4128 or Gary T. Engel at (202) 512-8815. Individuals making key contributions to this testimony included Phyllis L. Anderson, Thomas Melito, Roger R. Stoltz, Bruce Kutnick, David T. Genser, Charles E. Norfleet, Barbara R. Shields, Michael Tenkate, Norman T. Thorpe, and Kate Woodward.

[30] The IMF has never activated the investment account because, according to IMF officials, the Fund has not had the available excess liquidity allowing for the transfer of such resources to the investment account.

[31] On May 20, 1947, an IMF Executive Board Decision No. 170-3 stated that "gold and currency subscribed to the Fund are clearly within its unrestricted ownership. They do not belong in any way to the subscriber."

[32] Art. V, sect. 12 (e).

IMF Members' Reserve Tranche Positions

Each member of the IMF is assigned a quota. Twenty-five percent of the member's quota subscription is normally payable in reserve assets (originally in gold, and since the second amendment of the Articles of Agreement in 1978, in SDRs or currencies of other members considered strong by the IMF), and the remainder is payable in the member's own currency. These reserve assets are considered to be part of the member's international reserves and can be withdrawn by the member upon representation of a balance of payments need. If withdrawn, members do not have to replenish their reserve asset drawings, but they must replace the withdrawn amount with their currency.

Reserve tranche positions are liquid claims of members on the IMF that arise in part from members' reserve asset payments. In addition, reserve tranche positions arise from the sale by the IMF of the currencies of members considered to be in strong external positions. We reviewed each member's reserve tranche position based upon data in IMF's International Financial Statistics as of April 30, 1999, and separated IMF members into three categories: creditors, neutral, and borrowers

- Creditors have the highest reserve tranche positions that exceed 25 percent of their quota. With a reserve tranche position of $23 billion and a quota of $50 billion, the United States had the largest reserve tranche position. Other G-10 members' reserve tranche positions and quotas approximate $42 billion and $102 billion, respectively. During the past 20 years, the IMF has considered most of the G-10 members' currency to be strong enough for use in IMF's operations. As of April 30, 1999, the reserve tranche positions and quotas of members considered in a strong position totaled about $81 billion and $189 billion, respectively. (see table I.1)
- Neutral members are those who may have drawn on all or part of their own reserve tranche positions but did not have IMF borrowings outstanding. The reserve tranche positions of these members are between zero to 25 percent of their quotas. About 60 percent of these members actually had zero reserve tranche positions, while those with partial reserve tranches balances totaled about $3 billion as of April 30, 1999. Neutral members had quotas of $31 billion as of April 30, 1999. (see table I.2)
- Borrowing members are users of IMF credit. Most of these members do not have any reserve tranche positions, and all of these members have withdrawn at least part of their reserve assets. As of April 30, 1999, the reserve tranche positions and quotas of these members totaled $2 billion and $61 billion, respectively. (see table I.3)

Table I.1: Creditor Members' Reserve Tranche Positions and Quotas as of April 30, 1999

In billions of dollars

Creditor Countries[a]	Reserve Tranche Position	Quota	Reserve Tranche Position as Percent of Quota
United States	$23.05	$50.20	46
Japan	8.26	17.99	46
Germany	7.72	17.58	44
France	5.39	14.51	37
United Kingdom	5.30	14.51	37
Italy	3.99	9.53	42
China	3.38	6.33	53
Canada	3.00	8.61	35
Netherlands	2.94	6.98	42
Switzerland	2.10	4.67	45
Spain	1.90	4.12	46
Belgium	1.72	4.19	41
Australia	1.56	4.37	36
Sweden	1.30	3.24	40
Austria	1.09	2.53	43
Norway	1.03	2.26	46
Denmark	0.96	2.22	43
Malaysia	0.82	2.01	41
Finland	0.73	1.71	43
Colombia	0.57	1.05	55
Chile	0.55	1.16	48
Libya	0.53	1.52	35
Portugal	0.53	1.17	45
Ireland	0.48	1.13	43
Singapore	0.44	1.17	38
New Zealand	0.44	1.21	36
Greece	0.34	1.11	30
United Arab Emirates	0.26	0.53	48
Slovenia	0.09	0.31	30
Bahrain	0.08	0.18	45
Oman	0.07	0.26	26
Malta	0.05	0.14	39

(continued)

Creditor Countries[a]	Reserve Tranche Position	Quota	Reserve Tranche Position as Percent of Quota
Botswana	0.04	0.09	44
Total	$80.70	$188.57	

[a]GAO defines creditor countries as those members whose reserve tranche position in the Fund exceeds 25 percent according to IMF's publicly available International Financial Statistics.

Table I.2: Neutral Members' Reserve Tranche Positions and Quotas as of April 30, 1999

In billions of dollars

Countries in Neutral Position[a]	Reserve Tranche Position	Quota	Reserve Tranche Position as Percent of Quota
Saudi Arabia	$1.33	$9.44	14
Kuwait	0.45	1.87	24
Poland	0.23	1.85	13
Hungary	0.17	1.40	12
Egypt	0.16	1.28	13
Morocco	0.10	0.79	12
Israel	0.09	1.25	7
Cyprus	0.05	0.19	25
Brunei Darussalam	0.05	0.20	24
Qatar	0.04	0.26	14
Paraguay	0.03	0.13	21
Costa Rica	0.03	0.22	12
Lebanon	0.03	0.20	13
Iceland	0.03	0.16	16
Luxembourg	0.02	0.18	12
Fiji	0.02	0.09	21
Mauritius	0.02	0.14	14
Swaziland	0.01	0.07	13
Bahamas, The	0.01	0.13	7
Suriname	0.01	0.12	7
Afghanistan, I.S. of	0.01	0.16	4
Barbados	0.01	0.09	7
Belize	0.01	0.03	23
Vanuatu	0.00	0.02	15
San Marino	0.00	0.01	24

(continued)

Countries in Neutral Position[a]	Reserve Tranche Position	Quota	Reserve Tranche Position as Percent of Quota
Tonga	0.00	0.01	25
Maldives	0.00	0.01	19
Bhutan	0.00	0.01	16
Samoa	0.00	0.02	6
Solomon Islands	0.00	0.01	5
St.Vincent and Grenadines	0.00	0.01	8
South Africa	0.00	2.52	0
Nigeria	0.00	2.37	0
Namibia	0.00	0.13	0
Trinidad and Tobago	0.00	0.45	0
Dominica	0.00	0.01	0
Syrian Arab Republic	0.00	0.40	0
Eritrea	0.00	0.02	0
Turkmenistan	0.00	0.06	0
Czech Republic	0.00	1.11	0
Antigua and Barbuda	0.00	0.02	0
Cape Verde	0.00	0.01	0
Palau	0.00	0.00	0
St. Lucia	0.00	0.02	0
Marshall Islands	0.00	0.00	0
Micronesia, Federated States of	0.00	0.00	0
Angola	0.00	0.39	0
El Salvador	0.00	0.23	0
Grenada	0.00	0.01	0
Guatemala	0.00	0.21	0
Iran, I.R. of	0.00	2.02	0
Iraq	0.00	0.68	0
Kiribati	0.00	0.01	0
Myanmar	0.00	0.35	0
Seychelles	0.00	0.01	0
Total	**$2.89**	**$31.42**	

[a]GAO defines countries in neutral positions as those members whose reserve tranche position in the Fund is 25 percent or less but did not have IMF borrowings outstanding according to IMF's publicly available International Financial Statistics.

Table I.3: Borrower Members' Reserve Tranche Positions and Quotas as of April 30, 1999

In billions of dollars

Borrower Countries[a]	Reserve Tranche Position	Quota	Reserve Tranche Position as Percent of Quota
India	$0.66	$5.62	12
Venezuela	0.43	3.59	12
Korea	0.28	2.21	13
Indonesia	0.20	2.81	7
Turkey	0.15	1.30	12
Philippines	0.12	1.19	10
Algeria	0.11	1.70	7
Sri Lanka	0.06	0.56	12
Ghana	0.06	0.50	11
Bulgaria	0.04	0.87	5
Tunisia	0.03	0.39	7
Ecuador	0.02	0.41	6
Uruguay	0.02	0.30	7
Kenya	0.02	0.37	5
Panama	0.02	0.28	6
Tanzania	0.01	0.27	5
Bolivia	0.01	0.23	5
Mali	0.01	0.13	9
Honduras	0.01	0.17	7
Niger	0.01	0.09	13
Burkina Faso	0.01	0.08	12
Ethiopia	0.01	0.18	5
Armenia	0.01	0.12	7
Burundi	0.01	0.10	8
Nepal	0.01	0.10	8
Lesotho	0.00	0.05	10
Albania	0.00	0.07	7
Malawi	0.00	0.09	3
Benin	0.00	0.08	4
Gambia, The	0.00	0.04	5
Senegal	0.00	0.22	1

(continued)

Borrower Countries*	Reserve Tranche Position	Quota	Reserve Tranche Position as Percent of Quota
Djibouti	0.00	0.02	7
Russian Federation	0.00	8.03	0
Comoros	0.00	0.01	6
Congo, Republic of	0.00	0.11	1
Cameroon	0.00	0.25	0
Chad	0.00	0.08	1
Togo	0.00	0.10	0
Zimbabwe	0.00	0.48	0
Mexico	0.00	3.49	0
Cote d'Ivoire	0.00	0.44	0
Bangladesh	0.00	0.72	0
Croatia	0.00	0.49	0
Central African Republic	0.00	0.08	0
Guinea	0.00	0.14	0
Pakistan	0.00	1.40	0
St. Kitts and Nevis	0.00	0.01	1
Gabon	0.00	0.21	0
Papua New Guinea	0.00	0.18	0
Haiti	0.00	0.08	0
Liberia	0.00	0.10	0
Madagascar	0.00	0.17	0
Sierra Leone	0.00	0.14	0
Thailand	0.00	1.46	0
Belarus	0.00	0.52	0
Zambia	0.00	0.68	0
Lithuania	0.00	0.19	0
Yemen, Republic of	0.00	0.33	0
Sudan	0.00	0.23	0
Georgia	0.00	0.20	0
Azerbaijan	0.00	0.22	0
Ukraine	0.00	1.85	0
Mozambique	0.00	0.15	0
Estonia	0.00	0.06	0
Vietnam	0.00	0.44	0
Kazakhstan	0.00	0.49	0
Latvia	0.00	0.17	0

(continued)

Borrower Countries[a]	Reserve Tranche Position	Quota	Reserve Tranche Position as Percent of Quota
Moldova	0.00	0.17	0
Uzbekistan	0.00	0.37	0
Kyrgyz Republic	0.00	0.12	0
Mongolia	0.00	0.07	0
Dominican Republic	0.00	0.30	0
Jordan	0.00	0.23	0
Tajikistan	0.00	0.12	0
Guinea-Bissau	0.00	0.02	0
Argentina	0.00	2.86	0
Bosnia & Herzegovina	0.00	0.23	0
Brazil	0.00	4.10	0
Cambodia	0.00	0.12	0
Congo, Dem. Rep.	0.00	0.39	0
Equatorial Guinea	0.00	0.04	0
Guyana	0.00	0.12	0
Jamaica	0.00	0.37	0
Lao P.D.R.	0.00	0.05	0
Macedonia,fmr.Yug.Rep.	0.00	0.09	0
Mauritania	0.00	0.09	0
Nicaragua	0.00	0.18	0
Peru	0.00	0.86	0
Romania	0.00	1.39	0
Rwanda	0.00	0.11	0
Sao Tomé and Principe	0.00	0.01	0
Slovak Republic	0.00	0.48	0
Somalia	0.00	0.06	0
Uganda	0.00	0.24	0
Total	**$2.36**	**$61.04**	

[a]GAO defines borrower countries as those members whose reserve tranche position in the Fund is 25 percent or less and had IMF borrowings outstanding according to IMF's publicly available International Financial Statistics.

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National Security and
International Affairs Division

November 19, 1999

The Honorable Jim Saxton
Vice Chairman
Joint Economic Committee
U.S. Congress

Subject: Response to Questions About the International Monetary Fund's Finances

Dear Mr. Saxton:

As you requested, we are providing you with additional information on various aspects of the International Monetary Fund's (IMF) finances. Our report, International Monetary Fund: Observations on the IMF's Financial Operations (GAO/NSIAD/AIMD-99-252), discusses some of the issues you raised in your request. We have included a copy of this report and have identified the sections that provide information on your request. This letter responds to your remaining questions.

QUESTIONS AND ANSWERS

Question:

How much have the functions of the IMF changed relative to the days of the fixed exchange rate system with gold and the dollar at its center? Is the same degree of change evident in the IMF's financial and accounting concepts and methods since this time? Was not the IMF accounting system designed for, and largely rooted in, an institutional environment that no longer exists?

Answer:

The focus of our efforts in the area of the IMF's finances has centered mainly on (1) the IMF's liquidity position, including its experience with borrowing resources to meet its members' financing needs; (2) the role of gold holdings in the Fund's operations; (3) the Fund's process for determining the amount of quota contributions required from its members; and (4) information on how the IMF's lending activities have evolved since it was founded. In our September 1999 report, we described how some of the Fund's financial activities, such as the shift in the IMF's lending from a mix of industrialized and developing countries to developing countries only and the elimination of gold's formal role in the IMF and in international currency transactions, have changed since the Fund's creation. Although we reviewed many of the Fund's financial activities and policies, the scope of our work was limited to the areas described above and did not permit us to gather sufficient information to describe and evaluate the nature and degree of change in the IMF's functions and its financial and accounting concepts since the Fund's creation.

Question:

Of the total reserve tranche position in excess of 25 percent of a member's quota, what percent of these excess contributions is contributed by the United States, Japan, Germany, and France combined?

Answer:

Enclosure I provides data on each of the 34 IMF members whose reserve tranche position exceeded 25 percent of its quota subscription as of April 30, 1999. For the United States, Japan, Germany, and France combined, the excess reserve tranche position was about $19 billion or 58 percent of the total excess of approximately $34 billion. The contributions of these four countries accounted for about 36 percent of the IMF's total quota contributions as of April 30, 1999.

Question:

According to a recent Bretton Woods study, IMF "lending rates are subsidized." This was a point that our research at the Joint Economic Committee has repeatedly emphasized. What portion of IMF lending is at the standard loan rate, and how does the current level of that rate at about 3.8 percent compare with the rate on comparable U.S. Treasury securities?

Answer:

The IMF's audited financial statements as of April 30, 1999, report that of the $82 billion in outstanding credit (General Resources Account) about $65 billion, or 79 percent, represents funds lent at the standard IMF loan rate. The remaining $17 billion, or 21 percent, consists of funds lent under the Supplemental Reserve Facility that has an interest rate that is 300 to 500 basis points higher than the standard loan rate.

On May 1, 1989, the standard loan rate was modified to be based on a proportion of the Special Drawing Rights (SDR) interest rate and changes weekly with fluctuations in the SDR interest rate. For the financial year ended April 30, 1999, the proportion was set at 107 percent of the estimated SDR rate of 3.43 percent or 3.67 percent. Added to this amount is a rate for 0.13 percent to cover potential loan losses under burden sharing, for a total rate of 3.80 percent for all lending facilities except the SRF. The SDR interest rate is a weighted average of the rates on 3-month instruments in the capital markets of the five IMF members that comprise the SDR, including the United States. Table 1 below shows average interest rates for the period May 1, 1998 through April 30, 1999, for these IMF members.

Table 1: Average Annual Interest Rates, May 1998 – April 1999

	Type of financial instrument	Average annual interest rate[a]
IMF standard loan rate	Not applicable	3.80[b]
United States	Treasury bill rate (bond equivalent)	4.63
Germany	Interbank deposit rate (IMF-SDR)	3.33
Japan	Private bill rate	0.53
France	Treasury bill rate	3.25[a]
United Kingdom	Treasury bill rate (bond equivalent)	6.55[a]

Source: GAO analysis of the IMF's International Financial Statistics.

[a]Interest rate data for February and March 1999 were not available for France and the United Kingdom. As a result, the average interest rate was calculated without data for these 2 months.

[b]The IMF Standard loan rate is an IMF estimate for the quarter ended April 30, 1999 and includes the burden-sharing effect and the charge for administrative expenses.

Question:

The Bretton Woods study points out that the IMF in recent years has been "segmented into distinct factions of providers and users of resources." Isn't this reflected in the heavy reserve positions and contributions of the advanced industrial nations and very low or nonexistent reserve positions and contributions of about half of IMF member nations? Also, how many members have withdrawn their reserve positions after making the 25-percent quota contributions in usable currencies under the recent quota increase?

Answer:

From 1947 through 1977, IMF lending to industrial countries accounted for about half of the total of the IMF's General Resources Account outstanding credit.[1] However, industrial countries' use of IMF resources decreased rapidly, and by 1988, all users of IMF resources were developing countries. The main cause of this change over time is that industrial countries developed increased access to funds provided by financial markets to satisfy their external financing requirements. However, many developing countries do not have sufficient access to capital markets, particularly in periods of financial distress, and continue to rely upon the IMF for financial support.

In addition, industrial countries have consistently provided the bulk of the Fund's "usable" resources. For example, as shown in enclosure I, as of April 30, 1999, 21 of

[1]A detailed discussion of the trends of users of IMF credit is presented in International Monetary Fund: Observations of Financial Operations.

the 24 industrialized countries'[2] reserve tranche positions constituted about $74 billion, or about 86 percent, of the IMF's total reserve tranche positions of $86 billion, while these countries contributed only about $174 billion, or 62 percent, of the IMF's total quota contributions of $281 billion. The 158 developing countries' reserve tranche positions totaled about $12 billion, or about 14 percent, of the IMF's total reserve tranche positions as of April 30, 1999. Quota contributions for developing countries totaled $107 billion, or 38 percent, of the IMF's total quota contributions for that same period. Additionally, 145 developing countries had reserve tranche positions of less than 25 percent of their quota, with most at zero or less than 5 percent as of April 30, 1999.

Through April 30, 1999, we identified 92 developing countries that withdrew about $3.6 billion, or the entire 25 percent, of quota increase that they had paid in usable currencies or SDRs from the January 1999 Eleventh General Review of quota, (see enclosure II). This amount was replaced with an equivalent amount of their national currency. Also, as of April 30, 1999, another 27 developing countries owed a total of about $5 billion related to the quota increase, including 25 percent, or about $1.25 billion, payable in usable currencies or SDRs.[3]

Question:

The IMF's balance sheet values the promissory notes of all countries at face value, although some of these countries have such low credit ratings that these notes could be heavily discounted or even considered worthless. From a financial and accounting point of view, should notes contributed by members with poor credit ratings necessarily be valued on the IMF balance sheet at face value the same way the obligations of the most creditworthy countries are? What is the IMF's rationale for the current approach?

Answer:

The IMF's bylaws mandate that its accounts and statements provide a "true and fair view" of its financial position. Moreover, the IMF is not bound by specific legal provisions or accounting pronouncements in effect in individual member countries and, as a result, its accounting treatment of certain items can vary from U.S. generally accepted accounting principles. The IMF states that the standards and pronouncements of its individual members are, however, taken into consideration in the development of the IMF's accounting practices and in the preparation of its financial activities in the financial statements.

Although the IMF treats all of its notes and currency holdings at face value on its balance sheet, the Fund separates its total resources contributed by its most credit- worthy members (that is, its usable resources) from the resources of its members who are using IMF credit or have relatively weak external positions, in the IMF's Financial Resources and Liquidity Position statement (see enclosure III). This liquidity statement is now an

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[2]The IMF considers 24 members to be industrialized countries: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Portugal, San Marino, Spain, Sweden, Switzerland, the United Kingdom, and the United States.

[3]A more detailed discussion is presented in International Monetary Fund: Current Financial Situation (GAO/T-NSIAD/AIMD-99-254).

integral part of the Fund's audited financial statements and is included in its annual report for its financial year ending April 30, 1999. By reviewing the IMF's balance sheet, footnotes, and liquidity statement, users of its financial statements can ultimately determine the total amount of resources provided by the Fund's strongest members. IMF officials have stated that revealing the identities of countries whose currency the IMF considers as strong enough to be used to finance IMF operations and transactions is extremely sensitive. Therefore, the IMF does not permit public disclosure of such information due to the potential negative impact the release of this information could have on these countries and on financial markets. As a result, information on the financial strength or weakness of individual members is not disclosed. However, it can be estimated by reviewing the members' reserve tranche positions as shown in enclosure IV.

Question:

Didn't this Bretton Woods system, including the official price of gold, collapse in the 1970s?

Answer:

According to the IMF,[4] from its inception through the early 1970s, gold occupied a central role in the international monetary system. According to the Bretton Woods system, the value of each currency was expressed in terms of gold (par value), and IMF members were obliged to keep the exchange rates for their currencies within 1 percent of parity. In practice, most countries fulfilled these obligations by observing the par value against the U.S. dollar and by buying or selling their currencies for U.S. dollars, while the United States undertook to buy and sell gold freely for U.S. dollars at $35 per fine ounce, the par value of the U.S. dollar, which was equivalent to US$1 per 0.88671 gram of fine gold. This was the official price of gold, at which all IMF transactions and operations in gold were conducted. In August 1971, the United States announced that it would no longer buy and sell gold at the official price. This announcement was followed shortly by the effective breakdown of the Bretton Woods par value system, with the devaluation of the U.S. dollar in December 1971, and by the generalized floating of exchange rates in March 1973. The second amendment of the Articles, approved in 1978 by IMF members, contained comprehensive new provisions that were designed to reduce the role of gold in the international monetary system and the IMF, to make the SDR the principal reserve asset. In accordance with the Articles, since the date of the second amendment the IMF's assets have been valued in terms of SDR. Gold held at the time of the second amendment is valued at SDR 35 for an ounce of fine gold, the former official price of gold, whereas the valued of gold accepted by the IMF after that date is decided by the IMF's Executive Board.

Question:

Has the GAO specifically asked the IMF what subsequent legal analysis exists justifying its apparent claim to the potential profits arising in an entirely different institutional context relative to that of 1947? Is there any written justification for the position after the collapse of the Bretton Woods system?

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[4] Financial Organization and Operations of the IMF, 45th Edition (Washington, D.C.: IMF, 1998).

Answer:

Both the IMF and U.S. Treasury Offices of General Counsel state that to their knowledge, there are no internally generated legal analyses that exist that discusses the IMF's ownership of gold profits. They believe that such analysis does not exist because the issue of the IMF's ownership of gold profits is embodied in the Fund's Articles of Agreement. In addition, they are not aware of any document that discusses the Fund's right to gold profits that was written after the IMF left the gold standard.

Question:

Can you provide a copy of the IMF's 1947 Executive Board Decision regarding the ownership of gold for the record?

Answer:

The IMF's Executive Board Decision No. 170-3, dated May 20, 1947, states that "gold and currency subscribed to the Fund are clearly within its unrestricted ownership. They do not belong in any way to the subscriber." A copy of the decision is included as enclosure V.

Question:

What was the gold price received by the United States relative to the market price of gold at the time of restitution?

Answer:

The IMF restituted 25 million ounces of gold to members between 1977 and 1980. Under this restitution program, the United States purchased 5.74 million ounces of gold from the Fund for approximately $248 million at the official price of SDR 35 per fine ounce, or an average price of about $43.2 per fine ounce. The United States' share of restituted gold was calculated on the basis of member quotas as of August 31, 1975. The United States elected to retain its restituted gold as a reserve asset, and thus no "profits" were ever realized in connection with this transfer. If the United States had sold this gold, it might have received approximately $228 per ounce (based on the average price of gold sold during the 1976 - 80 period), or about $1.3 billion in proceeds.

If you have any questions regarding this letter, please contact me at (202) 512-4128. The key contributor to this assignment was Phyllis Anderson.

Sincerely yours,

Harold J. Johnson

Harold J. Johnson, Associate Director
International Relations and Trade Issues

Enclosures

 ENCLOSURE I

RESERVE TRANCHE POSITIONS OF CREDITOR COUNTRIES AS OF APRIL 30, 1999

Dollars in billions

	Creditor Country[a]	Reserve tranche position	25 percent of quota	Reserve tranche in excess of 25 Percent of quota
1	United States	$23.06	$12.56	$10.50
2	Japan	8.26	4.50	3.76
3	Germany	7.72	4.39	3.33
4	France	5.39	3.63	1.76
5	United Kingdom	5.30	3.63	1.67
6	Italy	3.99	2.38	1.61
7	Canada	3.00	2.15	0.85
8	Netherlands	2.94	1.74	1.20
9	Switzerland	2.10	1.17	0.93
10	Spain	1.90	1.03	0.87
11	Belgium	1.72	1.05	0.67
12	Australia	1.56	1.09	0.47
13	Sweden	1.30	0.81	0.49
14	Austria	1.09	0.63	0.46
15	Norway	1.03	0.56	0.47
16	Denmark	0.96	0.55	0.41
17	Finland	0.73	0.43	0.30
18	Portugal	0.53	0.29	0.24
19	Ireland	0.48	0.28	0.20
20	New Zealand	0.44	0.30	0.14
21	Greece	0.34	0.28	0.06
	Industrial countries (subtotal)	$73.83	$43.44	$30.39
1	China, P.R.; Mainland	3.38	1.58	1.80
2	Malaysia	0.82	0.50	0.32
3	Colombia	0.57	0.26	0.31
4	Chile	0.55	0.29	0.26
5	Libya	0.53	0.38	0.15
6	Singapore	0.44	0.29	0.15
7	United Arab Emirates	0.26	0.13	0.13
8	Slovenia	0.09	0.08	0.01
9	Bahrain	0.08	0.06	0.03
10	Oman	0.07	0.07	0.00
11	Malta	0.05	0.03	0.02
12	Cyprus	0.05	0.05	0.00
13	Botswana	0.04	0.02	0.02
	Developing countries (subtotal)	$6.93	$3.73	$3.20
	Subtotal (34 countries)	$80.76	$47.17	$33.59
	Other countries	5.18	23.01	--
	Total	$85.94	$70.18	$33.59
	Total for U.S., Japan, Germany and France	$44.42	$25.07	$19.35
	Percent of total	51.69%	35.72%	57.61%

[a]GAO defines creditor countries as those members whose reserve tranche position in the Fund exceeds 25 percent of its quota.

Source: GAO analysis of IMF's International Financial Statistics.

ENCLOSURE II

ELEVENTH GENERAL REVIEW'S QUOTA INCREASE AND RELATED RESERVE TRANCHE DRAWINGS THROUGH APRIL 30, 1999 FOR CERTAIN MEMBERS

U.S. Dollars in millions

Country	Eleventh General Review's quota increase	Reserve tranche contribution and withdrawal (25 percent of quota increase)
Angola	$107	$27
Antigua & Barbuda	7	2
Argentina	784	196
Azerbaijan	59	15
Bangladesh	190	48
Belarus	143	36
Benin	22	6
Bolivia	61	15
Bosnia & Herzegovina	65	16
Brazil	1,169	292
Bulgaria	237	59
Burkina Faso	22	5
Burundi	27	7
Cambodia	30	8
Cameroon	68	17
Cape Verde	4	1
Central African Republic	20	5
Chad	20	5
Comoros	3	1
Congo, Republic of	36	9
Cote d'Ivoire	118	29
Croatia	140	35
Czech Republic	310	78
Dominican Republic	81	20
Ecuador	112	28
El Salvador	62	15
Equatorial Guinea	11	3
Eritrea	6	1
Ethiopia	48	12
Gabon	59	15
Gambia, The	11	3
Georgia	53	13

 ENCLOSURE II

Country	Eleventh General Review's quota increase	Reserve tranche contribution and withdrawal (25 percent of quota increase)
Guinea	38	10
Guinea-Bissau	5	1
Guyana	32	8
Iran, Islamic Republic of	566	141
Jamaica	98	25
Jordan	66	16
Kazakhstan	160	40
Kenya	97	24
Kiribati	2	1
Kyrgyz Republic	33	8
Latvia	48	12
Lesotho	15	4
Lithuania	55	14
Macedonia, former Yugoslav Republic of	26	7
Madagascar	43	11
Malawi	25	6
Mali	33	8
Mauritania	23	6
Mexico	1,125	281
Moldova	45	11
Mongolia	19	5
Mozambique	40	10
Myanmar	99	25
Nepal	26	7
Nicaragua	46	11
Niger	24	6
Nigeria	637	159
Pakistan	372	93
Palau	1	*
Panama	77	19
Papua New Guinea	49	12
Peru	233	58
Philippines	333	83
Romania	373	93
Russian Federation	2,206	551
Rwanda	28	7
Sao Tomé & Príncipe	3	1
Samoa	4	1

ENCLOSURE II

Country	Eleventh General Review's quota increase	Reserve tranche contribution and withdrawal (25 percent of quota increase)
Senegal	58	14
Seychelles	4	1
Sierra Leone	36	9
Slovak Republic	135	34
Solomon Islands	4	1
South Africa	680	170
St. Kitts and Nevis	3	1
St. Lucia	6	1
Syrian Arab Republic	113	28
Tajikistan	36	9
Tanzania	70	18
Thailand	686	172
Togo	26	6
Trinidad & Tobago	120	30
Uganda	63	16
Ukraine	506	127
Uzbekistan	103	26
Vanuatu	6	2
Vietnam	118	30
Yemen, Republic of	91	23
Zambia	170	42
Zimbabwe	124	31
Total	$14,348	$3,587

Note: SDR exchange rate = $1.35123

'Less than $1 million.

Source: GAO analysis of the IMF's International Financial Statistics.

Schedule 2

Financial Statements of the IMF

General Department

Financial Resources and Liquidity Position in the General Resources Account as at April 30, 1999 and 1998

(In thousands of SDRs)

	1999	1998
Resources		
Currencies and securities	204,966,259	144,638,372
SDR holdings	3,571,967	764,424
Gold holdings	3,624,797	3,624,797
Sundry assets, net of sundry liabilities[1]	379,550	310,860
Total resources	212,542,573	149,338,453
Less: Nonusable Resources[2]	128,833,525	102,060,131
Equals: Usable Resources[3]	83,709,048	47,278,322
Resources Committed and Working Balances		
Undrawn balances under arrangements[4]	13,059,802	15,293,169
Minimum working balances[4]	13,922,160	9,424,250
Resources committed and working balances	26,981,962	24,717,419
Net Uncommitted Usable Resources[5]	56,727,086	22,560,903
Liquid Liabilities		
Reserve tranche positions[6]	63,609,749	50,324,030
Liquidity Ratio[7]	89.2%	44.8%
Memorandum Item		
Resources available under borrowing arrangements	34,000,000	18,500,000

[1]Sundry assets, net of sundry liabilities reflect current assets (charges, interest, and other receivables) and other assets that include capital assets (land, buildings, and equipment), net of sundry liabilities (remuneration payable and other liabilities).

[2]Resources regarded as nonusable in the financing of the IMF's ongoing operations and transactions are (1) gold holdings, (2) currencies of members that are using IMF credit, (3) currencies of other members with relatively weak external positions, and (4) sundry assets, net of sundry liabilities.

[3]Usable resources consist of (1) holdings of currencies of members considered by the Executive Board as having balance of payments and reserve positions sufficiently strong for their currencies to be used in transfers, (2) SDR holdings, and (3) any unused amounts under credit lines that have been activated.

[4]Amounts committed under active arrangements, which reflect undrawn balances committed under operative Stand-By and Extended Arrangements, other than precautionary arrangements, are deducted from the total of usable resources, as are one-half of the amounts committed under precautionary arrangements. The Executive Board has decided that minimum working balances be set at 10 percent of the quotas of members deemed sufficiently strong for their currencies to be used in operations and transactions.

[5]Net uncommitted usable resources are defined as usable resources less resources committed under arrangements and minimum working balances, as described above. The amount represents the resources available to meet requests for use of IMF credit under new credit arrangements and for members' use of their reserve positions in the IMF.

[6]Liquid liabilities consist of (1) members' reserve tranche positions, and (2) the amount of any outstanding borrowing by the IMF under the GAB or NAB. Both reserve tranche positions and outstanding lending under the GAB and NAB (together called members' reserve positions in the IMF) are part of members' international reserves. The IMF cannot challenge a request by a member to draw on its reserve position when developments in its balance of payments or reserve position make this necessary, and the IMF must therefore at all times be in a position to meet such requests.

[7]The liquidity ratio is a measure of the IMF's liquidity position, represented by the ratio of its net uncommitted usable resources to its liquid liabilities. While this ratio is neither a fixed nor a minimum ratio, historically it has not fallen below 25–30 percent of liquid liabilities for any length of time, thereby ensuring the IMF's capacity to meet members' requests.

Source: IMF

ENCLOSURE IV

IMF MEMBERS' CREDITORS, NEUTRAL, AND BORROWERS

Creditors have the highest reserve tranche positions that exceed 25 percent of their quota. With a reserve tranche position of $23 billion and a quota of $50 billion, the United States had the largest reserve tranche position. Other Group of 10 members'reserve tranche positions and quotas approximate $42 billion and $102 billion, respectively. During the past 20 years, the IMF has considered most of the G-10 members' currency to be strong enough for use in IMF's operations. As of April 30, 1999, the reserve tranche positions and quotas of members considered in a strong position totaled about $81 billion and $189 billion, respectively (see table I.)

Neutral members are those who may have drawn on all or part of their own reserve tranche positions but did not have IMF borrowings outstanding. The reserve tranche positions of these members are between zero to 25 percent of their quotas. About 60 percent of these members actually had zero reserve tranche positions, while those with partial reserve tranches balances totaled about $3 billion as of April 30, 1999. Neutral members had quotas of $31 billion as of April 30, 1999 (see table II.)

Borrowing members are users of IMF credit. Most of these members do not have any reserve tranche positions, and all of these members have withdrawn at least part of their reserve assets. As of April 30, 1999, the reserve tranche positions and quotas of these members totaled $2 billion and $61 billion, respectively (see table III.)

Table I: Creditor Members' Reserve Tranche Positions and Quotas as of April 30, 1999

Dollars in billions

Creditor Countries[a]	Reserve Tranche Position	Quota	Reserve Tranche Position as Percent of Quota
United States	$23.06	$50.20	46
Japan	8.26	17.99	46
Germany	7.72	17.58	44
France	5.39	14.51	37
United Kingdom	5.30	14.51	37
Italy	3.99	9.53	42
China	3.38	6.33	53
Canada	3.00	8.61	35
Netherlands	2.94	6.98	42
Switzerland	2.10	4.67	45
Spain	1.90	4.12	46
Belgium	1.72	4.19	41
Australia	1.56	4.37	36
Sweden	1.30	3.24	40
Austria	1.09	2.53	43
Norway	1.03	2.26	46
Denmark	0.96	2.22	43
Malaysia	0.82	2.01	41
Finland	0.73	1.71	43
Colombia	0.57	1.05	55
Chile	0.55	1.16	48
Libya	0.53	1.52	35
Portugal	0.53	1.17	45
Ireland	0.48	1.13	43
Singapore	0.44	1.17	38
New Zealand	0.44	1.21	36
Greece	0.34	1.11	30
United Arab Emirates	0.26	0.53	48
Slovenia	0.09	0.31	30
Bahrain	0.08	0.18	45
Oman	0.07	0.26	26
Malta	0.05	0.14	39
Botswana	0.04	0.09	44
Total	$80.70	$188.57	

[a]GAO defines creditor countries as those members whose reserve tranche position in the Fund exceeds 25 percent according to IMF's publicly available International Financial Statistics.

Table II: Neutral Members' Reserve Tranche Positions and Quotas as of April 30, 1999

Dollars in billions

Countries in Neutral Position*	Reserve Tranche Position	Quota	Reserve Tranche Position as Percent of Quota
Saudi Arabia	$1.33	$9.44	14
Kuwait	0.45	1.87	24
Poland	0.23	1.85	13
Hungary	0.17	1.40	12
Egypt	0.16	1.28	13
Morocco	0.10	0.79	12
Israel	0.09	1.25	7
Cyprus	0.05	0.19	25
Brunei Darussalam	0.05	0.20	24
Qatar	0.04	0.26	14
Paraguay	0.03	0.13	21
Costa Rica	0.03	0.22	12
Lebanon	0.03	0.20	13
Iceland	0.03	0.16	16
Luxembourg	0.02	0.18	12
Fiji	0.02	0.09	21
Mauritius	0.02	0.14	14
Swaziland	0.01	0.07	13
Bahamas, The	0.01	0.13	7
Suriname	0.01	0.12	7
Afghanistan, I.S. of	0.01	0.16	4
Barbados	0.01	0.09	7
Belize	0.01	0.03	23
Vanuatu	0.00	0.02	15
San Marino	0.00	0.01	24
Tonga	0.00	0.01	25
Maldives	0.00	0.01	19
Bhutan	0.00	0.01	16
Samoa	0.00	0.02	6
Solomon Islands	0.00	0.01	5
St. Vincent and Grenadines	0.00	0.01	8
South Africa	0.00	2.52	0
Nigeria	0.00	2.37	0
Namibia	0.00	0.13	0
Trinidad and Tobago	0.00	0.45	0
Dominica	0.00	0.01	0
Syrian Arab Republic	0.00	0.40	0
Eritrea	0.00	0.02	0
Turkmenistan	0.00	0.06	0
Czech Republic	0.00	1.11	0
Antigua and Barbuda	0.00	0.02	0
Cape Verde	0.00	0.01	0

Countries in Neutral Position	Reserve Tranche Position	Quota	Reserve Tranche Position as Percent of Quota
Palau	0.00	0.00	0
St. Lucia	0.00	0.02	0
Marshall Islands	0.00	0.00	0
Micronesia, Federated States of	0.00	0.00	0
Angola	0.00	0.39	0
El Salvador	0.00	0.23	0
Grenada	0.00	0.01	0
Guatemala	0.00	0.21	0
Iran, I.R. of	0.00	2.02	0
Iraq	0.00	0.68	0
Kiribati	0.00	0.01	0
Myanmar	0.00	0.35	0
Seychelles	0.00	0.01	0
Total	$2.89	$31.42	

[a]GAO defines countries in neutral positions as those members whose reserve tranche position in the Fund is 25 percent or less but did not have IMF borrowings outstanding according to IMF's publicly available International Financial Statistics.

Table III: Borrower Members' Reserve Tranche Positions and Quotas as of April 30, 1999

Dollars in billions

Borrower Countries*	Reserve Tranche Position	Quota	Reserve Tranche Position as Percent of Quota
India	$0.66	$5.62	12
Venezuela	0.43	3.59	12
Korea	0.28	2.21	13
Indonesia	0.20	2.81	7
Turkey	0.15	1.30	12
Philippines	0.12	1.19	10
Algeria	0.11	1.70	7
Sri Lanka	0.06	0.56	12
Ghana	0.06	0.50	11
Bulgaria	0.04	0.87	5
Tunisia	0.03	0.39	7
Ecuador	0.02	0.41	6
Uruguay	0.02	0.30	7
Kenya	0.02	0.37	5
Panama	0.02	0.28	6
Tanzania	0.01	0.27	5
Bolivia	0.01	0.23	5
Mali	0.01	0.13	9
Honduras	0.01	0.17	7
Niger	0.01	0.09	13
Burkina Faso	0.01	0.08	12
Ethiopia	0.01	0.18	5
Armenia	0.01	0.12	7
Burundi	0.01	0.10	8
Nepal	0.01	0.10	8
Lesotho	0.00	0.05	10
Albania	0.00	0.07	7
Malawi	0.00	0.09	3
Benin	0.00	0.08	4
Gambia, The	0.00	0.04	5
Senegal	0.00	0.22	1
Djibouti	0.00	0.02	7
Russian Federation	0.00	8.03	0
Comoros	0.00	0.01	6
Congo, Republic of	0.00	0.11	1
Cameroon	0.00	0.25	0
Chad	0.00	0.08	1
Togo	0.00	0.10	0
Zimbabwe	0.00	0.48	0

Borrower Countries	Reserve Tranche Position	Quota	Reserve Tranche Position as Percent of Quota
Mexico	0.00	3.49	0
Cote d'Ivoire	0.00	0.44	0
Bangladesh	0.00	0.72	0
Croatia	0.00	0.49	0
Central African Republic	0.00	0.08	0
Guinea	0.00	0.14	0
Pakistan	0.00	1.40	0
St. Kitts and Nevis	0.00	0.01	1
Gabon	0.00	0.21	0
Papua New Guinea	0.00	0.18	0
Haiti	0.00	0.08	0
Liberia	0.00	0.10	0
Madagascar	0.00	0.17	0
Sierra Leone	0.00	0.14	0
Thailand	0.00	1.46	0
Belarus	0.00	0.52	0
Zambia	0.00	0.66	0
Lithuania	0.00	0.19	0
Yemen, Republic of	0.00	0.33	0
Sudan	0.00	0.23	0
Georgia	0.00	0.20	0
Azerbaijan	0.00	0.22	0
Ukraine	0.00	1.85	0
Mozambique	0.00	0.15	0
Estonia	0.00	0.06	0
Vietnam	0.00	0.44	0
Kazakhstan	0.00	0.49	0
Latvia	0.00	0.17	0
Moldova	0.00	0.17	0
Uzbekistan	0.00	0.37	0
Kyrgyz Republic	0.00	0.12	0
Mongolia	0.00	0.07	0
Dominican Republic	0.00	0.30	0
Jordan	0.00	0.23	0
Tajikistan	0.00	0.12	0
Guinea-Bissau	0.00	0.02	0
Argentina	0.00	2.88	0
Bosnia & Herzegovina	0.00	0.23	0
Brazil	0.00	4.10	0
Cambodia	0.00	0.12	0
Congo, Dem. Rep.	0.00	0.39	0
Equatorial Guinea	0.00	0.04	0
Guyana	0.00	0.12	0
Jamaica	0.00	0.37	0
Lao P.D.R.	0.00	0.06	0
Mauritania	0.00	0.09	0

Borrower Countries	Reserve Tranche Position	Quota	Reserve Tranche Position as Percent of Quota
Nicaragua	0.00	0.18	0
Peru	0.00	0.86	0
Romania	0.00	1.39	0
Rwanda	0.00	0.11	0
Sao Tomé and Príncipe	0.00	0.01	0
Slovak Republic	0.00	0.48	0
Somalia	0.00	0.06	0
Uganda	0.00	0.24	0
Total	$2.36	$61.04	

[a]GAO defines borrower countries as those members whose reserve tranche position in the Fund is 25 percent or less and had IMF borrowings outstanding according to IMF's publicly available International Financial Statistics.

United States General Accounting Office

GAO

Report to Congressional Committees

September 1999

INTERNATIONAL MONETARY FUND

Observations on the IMF's Financial Operations

GAO

Accountability • Integrity • Reliability

GAO/NSIAD/AIMD-99-252

Enclosure V

IMF's EXECUTIVE BOARD DECISION NO. 170-3

[For increases in Quotas of Members—Tenth General Review, see pages 622-24]

GOLD AND CURRENCY SUBSCRIBED TO THE FUND AND ACCOUNTING BY MEMBERS FOR TRANSACTIONS WITH THE FUND

The following principles should be observed by members in reflecting their participation in the Fund in their accounts:

(1) Gold and currency subscribed to the Fund are clearly within its unrestricted ownership. They do not belong in any way to the subscriber.

(2) Although the accounting practices of a member are primarily its own concern, each member should prepare its accounts in such a way that misconceptions as to the ownership of the gold and currency subscribed to the Fund would be avoided. . . .

Decision No. 170-3
May 20, 1947

Source: IMF

Contents

Abbreviations

BIS	Bank for International Settlements
BSFF	Buffer Stock Financing Facility
CCFF	Compensatory and Contingency Financing Facility
CFF	Compensatory Financing Facility
DRC	Democratic Republic of Congo
EAR	Enlarged Access to Resources Facility
EFF	Extended Fund Facility
ERM	Exchange Rate Mechanism
ESAF	Enhanced Structural Adjustment Facility
GAB	General Arrangements to Borrow
G-7	Group of 7 Industrialized Countries
G-10	Group of 11 Industrialized Countries
GRA	General Resources Account
HIPC	Heavily Indebted Poor Countries
IMF	International Monetary Fund
NAB	New Arrangements to Borrow
SAF	Structural Adjustment Facility
SAMA	Saudi Arabia Monetary Agency
SCA	Special Contingent Account
SDA	Special Disbursement Account
SDR	Special Drawing Rights
SFF	Supplemental Financing Facility
SRF	Supplemental Reserve Facility
STF	Systemic Transformation Facility

GAO
Accountability * Integrity * Reliability

United States General Accounting Office
Washington, D.C. 20548

National Security and
International Affairs Division

B-283253

September 30, 1999

Congressional Committees

The International Monetary Fund was established to promote international monetary cooperation, facilitate international trade by promoting exchange stability and orderly exchange arrangements and assist in eliminating foreign exchange restrictions. To facilitate congressional oversight of U.S. policy concerning the Fund, the Omnibus Appropriations Act for fiscal year 1999 required us to report on several matters,[1] including the financial operations of the Fund during its current financial year ending April 30, 1999, and historical information on its lending activities. This report describes (1) the International Monetary Fund's liquidity position as of April 30, 1999, including its experience with borrowed resources to meet its members' financing needs; (2) the role of gold holdings in the Fund's operations; and (3) the Fund's process for determining the amount of quota contributions required from its members. The report also includes information on how the International Monetary Fund's lending[2] activities have evolved since it was founded in 1945 and discusses the status of preparedness of the Fund's mission-critical and other key computer systems and member country status for the year 2000.

[1]The Omnibus Appropriations Act for fiscal year 1999 (Pub. L. 105-277, Oct. 21, 1998) appropriated about $18 billion for the International Monetary Fund and required us to report on a seven-point mandate for reviews of the Fund. We are addressing this mandate in three reports—this report on financial operations and lending activities; a second that addressed the terms and conditions for borrower countries, *International Monetary Fund: Approach Used to Establish and Monitor Conditions for Financial Assistance* (GAO/GGD/NSIAD-99-168, June 22, 1999); and a third that addressed borrower countries' trade policies, *International Monetary Fund: Trade Policies of IMF Borrowers* (GAO/NSIAD/GGD-99-174, June 22, 1999).

[2]With the exception of some financing for low-income countries, the International Monetary Fund does not loan funds to a country. Rather, the country "purchases" the currency it needs from the Fund with an equivalent amount of its own currency and then later "repurchases" its own currency on terms established by the Fund. For the purposes of this report, we use the terms "financial arrangement," "disbursement," and "loan" to refer to "purchases" and "repayments" to refer to "repurchases."

Much of the information reported is as of April 30, 1999, and to the extent possible, we used data audited[3] by the Fund's External Audit Committee. To satisfy our objectives, we reviewed and analyzed the International Monetary Fund's financial statements, operational budgets, liquidity reviews, policy documents, and staff position papers and met with Fund, U.S. Treasury, and other officials. We also reviewed information on the status of the Fund's efforts to ensure that its mission-critical systems are Year 2000 compliant. The scope of our work was focused on a review of the International Monetary Fund's General Resources Account[4] and did not include a review of the trust accounts for low-income members. Although historical data was not available for calculating the weighted average of interest rates on the Fund's lending portfolio for each year since its first loan in 1947, as the Omnibus Appropriations Act requested, we have provided information on the interest rates charged by the Fund over its history. An evaluation of Fund's efforts and related management structure and processes to address the Year 2000 problem was not within the scope of our work.[5] See appendix VI for a full description of our objectives, scope, and methodology.

[3]The financial statements are audited annually. For the financial year ended April 30, 1999, the Fund's External Audit Committee issued on June 24, 1999, an audit opinion that was equivalent to an "unqualified" or "clean" audit opinion. The audit report was released on September 12, 1999.

[4]The General Resources Account is used for most transactions between member countries and the International Monetary Fund. These transactions include the receipt of quota subscriptions, purchases and repurchases, and the repayment of principal to the Fund's lenders. The assets held in this account include members' currencies, the Fund's own holdings of Special Drawing Rights and gold.

[5]The Year 2000 problem is rooted in the way dates are recorded and computed in automated information systems. For the past several decades, systems have used two digits to represent the year, such as "99" representing 1999, to conserve electronic data storage and reduce costs. With this two-digit format, however, the year 2000 is indistinguishable from 1900 or 2001 from 1901, etc. As a result, system or application programs that use dates to perform calculations, comparison, or sorting may generate incorrect results or not function at all.

Results in Brief

The International Monetary Fund's financial operations are supported by quota contributions of its members, Special Drawings Rights,[6] and gold holdings. To supplement these resources, the Fund has access to credit lines with certain member countries, and it can borrow from sovereign governments, central banks, or private entities. The Fund uses its resources to lend to its members and to meet their requests for drawings on their reserve tranche positions.[7] The International Monetary Fund has never borrowed from private sources and the use of its gold holdings in its financial transactions ended when the Fund amended its Articles of Agreement in 1978. Its financial condition is derived from the various components of its financial operations, including its liquid and nonliquid resources, its resources available from borrowing, and its lending practices.

For the financial year ended April 30, 1999, the International Monetary Fund had about $287 billion in resources consisting primarily of currency holdings of members' national currencies, Special Drawing Rights, and gold holdings in the General Resources Account. These resources were primarily obtained from members' quota contributions. Of this amount, about $195 billion was considered usable, that is, was from members that were sufficiently strong economically to permit their currencies to be used

[6] The SDR is a reserve asset that IMF has used since 1969. Its value comprises a weighted average of the values of four currencies: the U.S. dollar, yen, euros, and pound sterling. Because the value of the SDR relative to these currencies changes daily, the U.S. dollar value of amounts converted from SDR also changes daily. The SDR is the unit of account for the Fund.

[7] Up to 25 percent of members' quota contributions must normally be paid in reserve assets, which are currencies that are freely usable in the principal foreign exchange markets (U.S. dollars, yen, euros, and pound sterling) or the Special Drawing Rights. The balance may be paid either in a country's national currency or with noninterest-bearing promissory notes. The portion paid in freely usable currency, or Special Drawing Rights, is referred to as the member's reserve asset or initial reserve tranche position. This portion can be drawn by the member as needed based upon a representation of a balance-of-payments need.

for Fund operations. The remaining $92 billion was considered unusable.[8] Of the $195 billion of usable resources, about $118 billion had been lent, committed, or reserved as working balances, leaving about $77 billion in liquid resources available for additional credit to International Monetary Fund members and to meet members' drawings on their reserve assets held by the Fund. The $77 billion in liquid resources gives the Fund a liquidity[9] ratio of nearly 89 percent compared to the Fund's historical low liquidity ratio, which has ranged between 25 percent to 30 percent. Fund officials told us that its financial condition is adequate to meet the projected needs of its members until the next scheduled quota review in 2002.

The International Monetary Fund has not drawn from its working balance reserve in over 20 years, as of April 30, 1999. Consequently, its resources available for lending, as of April 30, 1999, may be greater than reported. In addition, the Fund has established a liquidity ratio between 25 percent to 30 percent as a threshold below which it believes it would be imprudent to lend.[10] While a low-end liquidity threshold appears reasonable, we found no analytical basis for the minimum ratio used by the Fund. If the Fund's liquidity were to fall to a level considered too low, the Fund could under specified conditions supplement its resources by using its $46 billion in credit lines or by borrowing from sovereign governments, their central banks, or private entities.

With the end of the gold standard in the early 1970s and the passage of the second amendment to the International Monetary Fund's Articles of Agreement in April 1978, gold's formal role in the Fund and in international currency transactions was eliminated. The Fund's gold holdings as of

[8]The International Monetary Fund considers certain currencies and its gold holdings as unusable because they cannot be used to finance Fund transactions. Because the Fund holds substantial amounts of currencies of members that are indebted to the Fund and are experiencing balance-of-payments difficulties, and of other members whose financial positions are not strong, a considerable proportion of the Fund's national currency holdings is not considered usable. Quarterly, the Fund reassesses the financial strength and reserve positions of the members on the operational budget to determine if the members' currencies remain strong enough to be used or if other currencies have strengthened sufficiently to be included in Fund transactions.

[9]The Fund's liquidity ratio is determined by dividing its available and uncommitted liquid resources by its liquid liabilities, which consist of members' reserve tranche positions and any outstanding Fund borrowings.

[10]The underpinnings for the Fund's liquidity threshold derives from its unique nature among the international financial institutions.

April 30, 1999, had a market value of $30 billion. The Fund believes that its gold holdings add to the "fundamental strength" of its financial condition. In addition, the Fund views its gold holdings as being available to (1) meet creditors' claims on the Fund in the event of liquidation of the Fund, (2) replenish currency holdings if the Fund does not have sufficient liquid resources to meet members' drawings on their reserve tranche positions, and (3) use during contingencies and for its general operations. The International Monetary Fund continues to consider gold an important resource despite restrictions under the Articles of Agreement, which the Fund interprets as including the lack of authority to invest or manage its gold in order to earn an investment return. Moreover, although the Fund considers gold to be an important resource, there is a decreased willingness of some official institutions to hold gold. In 1995, the Fund examined the effect of selling its gold and investing the proceeds in interest-bearing financial instruments compared to the decision to hold its stock of gold. The decision to hold gold has resulted in tens of billions of dollars in forgone realized gains and investment income since 1980.

The International Monetary Fund has never formally adopted a method for determining members' initial quotas and subsequent quota increases because it believes that quantitative measures cannot fully reflect the considerations that appropriately bear on each member's position or on the total size of the Fund's resources. Thus, the Executive Board uses several factors, including the prospective demand for Fund resources, growth of world trade, and trends in the Fund's liquidity position, to decide on members' quota levels. Its decisions on quota increases are matters of judgment that involve quantitative, qualitative, and political considerations. Historically, quota increases have almost always been lower than the increase recommended by the Fund's staff. For example, Fund staff recommended a quota increase of 100 percent for the most recent review, but the Executive Board[11] approved an increase of only 45 percent, after considering various factors, including whether member governments would support such a large increase.

As part of its role in the international monetary system, the International Monetary Fund provides balance-of-payments assistance to members when needed. Since its establishment in 1945, the arrangements under which

[11]The Fund's Board of Governors votes on the recommendation made by the Executive Board for the quota increase. The recommendation is approved upon an 85-percent weighted majority of the voting power.

such assistance has been provided have evolved in response to changing world conditions and the needs of its member countries. This included a growth in the assistance provided, an expansion of the types of lending facilities[12] used, and the addition of facilities with longer repayment periods. These changes came about to meet the needs of its members as the composition of the countries needing assistance moved from a mix of industrialized and developing countries to developing countries only. Since the late 1970s, there has been an increase in arrears, and the Fund has taken various measures that have reduced the number of countries in arrears to five as of April 30, 1999. In addition, there has been a greater concentration of the Fund's resources provided to a smaller number of countries since the late 1970s. As of April 30, 1999, about 86 percent of its outstanding loan portfolio had been provided to 10 countries.[13] The Fund has increased its reserves for potential loan losses and adopted a program to share the cost of overdue obligations between debtor and creditor members.

The Year 2000 problem affects nearly every aspect of the international financial system—from the ability of internal systems that support International Monetary Fund operations to function properly to the ability of member nations to repay loans. While the Fund recognizes the importance of these actions and has taken steps to mitigate potential damage, it still faces some challenges in providing more complete assurance that its internal business processes will continue to function after the date change. Further, the Fund needs to complete its assessment of the impact of Year 2000 failures on the potential for increased demand for financing by its members.

Background

The International Monetary Fund (IMF) was established in 1945 as a cooperative, intergovernmental, monetary and financial institution that sought to promote currency exchange stability, provide balance-of-payments assistance, foster trade, and stimulate economic growth. Its initial membership of 39 member countries has grown to 182

[12]The International Monetary Fund provides resources to its members from the General Resources Account up to a specified amount and during a specified period, provided that the member observes the terms established in the arrangement.

[13]Refer to appendix IV for details.

members as of April 30, 1999. The IMF is managed by a Governing Board and a 24-member Executive Board, the IMF's primary decision-making body. The IMF's financial year ends on April 30 of each year, and its financial statements are audited annually by an external audit committee with assistance from an international public accounting firm. Although the Fund's financial statements are not bound by any national or international accounting principles, the IMF generally follows their concepts while taking into account the Fund's unique financial structure and operations. The key components of the IMF's financial operations are described in the following paragraphs.

Liquid Resources

The IMF's liquid resources consist of Special Drawing Rights (SDR) and usable national currencies provided primarily from members' quota subscriptions. These resources are used to provide financial assistance to members with balance-of-payments problems. When a member borrows from the Fund, the country purchases the currency it needs from the IMF with an equivalent amount of its national currency. The member later repurchases its currency using SDR or other currency on terms established by the IMF. Because the Fund's financial assistance is in the form of currency purchases by member countries, it does not reduce the combined total of its currency holdings in terms of SDR equivalents; that is, the funds are not lent out.[14] Instead, the composition of the IMF's currency holdings changes as "borrowers" replace the currency they purchase with their national currency. The relationship of the IMF's holdings of a member's national currency to the member's quota is an important one because it determines whether the member is a creditor, debtor, or in a neutral position with the IMF. With some exceptions, currencies of members who are creditors are considered usable by the IMF to finance transactions, while currencies of countries in a neutral borrowing or a debtor position are considered unusable by the IMF.

Borrowing Authorization

The IMF, in certain circumstances, has access to credit lines with groups of countries to finance lending to members and has activated these credit lines at various times in its history. Its principal credit lines are the General

[14]The IMF considers its financing to low-income developing countries on concessional (below-market-interest-rate) terms to be lending. This lending is financed from a trust account, the Enhanced Structural Adjustment Facility (ESAF) Trust that is administered by the IMF outside of its General Department.

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Arrangements to Borrow (GAB), established in 1962, and the New Arrangements to Borrow (NAB), established in 1998. As of April 30, 1999, the combined amount available to the IMF was $46 billion under the GAB and the NAB. The IMF also has had other arrangements to borrow from governments and central bank sources. It has authority for private-sector borrowing but has never utilized this source of funds.

Gold Holdings

The IMF holds about 103 million fine ounces of gold at designated depositories in four member countries.[15] The IMF values its gold at SDR 35 per fine ounce (about $47 per fine ounce as of April 30, 1999), its value at the time of acquisition.[16] Therefore, the gold holdings were valued on its balance sheet at SDR 3.6 billion (about $5 billion). However, the IMF reported in a footnote to its financial statements the market value of its gold holdings as of its financial year-end. On April 30, 1999, the market value of the IMF's gold holdings was about $30 billion.

Members' Quotas

Quotas are the membership dues that countries pay when they join the IMF and when there is an approved increase in such dues (a review of quotas is held every 5 years). Quotas comprise the bulk of the Fund's resources for providing financial assistance. Up to 25 percent of quotas must normally be paid in reserve assets, which are currencies that are freely usable in the principal foreign exchange markets (U.S. dollars, yen, euros, or the pound sterling) or SDR.[17] The balance may be paid either in a country's domestic currency or with noninterest-bearing promissory notes.[18] The portion paid in freely usable currency, or SDR, is referred to as the member's "reserve asset" or "initial reserve tranche position."

[15]These gold holdings are held in the United States, the United Kingdom, France, and India and represent about 9 percent of the world's official gold holdings, as of March 1999.

[16]An exception is a small amount of gold (21,396 ounces) that Cambodia gave to the IMF in December 1992 in partial settlement of an overdue loan obligation. The IMF valued this amount at SDR 5.1 million (about $6.8 million as of April 30, 1999).

[17]Articles of Agreement, Art. III, Sec. 3(a).

[18]Articles of Agreement, Art. III, Sec. 4. These promissory notes are made payable to the IMF, are denominated in the member's domestic currency, and are held by the member's designated central bank or other designated depository. The IMF views these notes as fully equivalent to its currency holdings because the IMF can cash the notes on demand within 24 hours to receive members' domestic currency. IMF members are obligated to maintain the SDR value of their quotas.

The IMF's Liquidity Position

As of April 30, 1999, the IMF estimated that it had about $77 billion available to meet members' draws on their reserve tranche positions and future lending needs, giving it a liquidity ratio of nearly 89 percent. IMF officials told us that its liquid resources are adequate to meet its members' projected financing needs until the next quota review, which is scheduled to begin in 2002. In calculating its available resources, the IMF deducted $19 billion for the maintenance of a working balance reserve, which the Fund believed was needed to pay members in specified currencies. Our analysis, however, indicates that the Fund has not drawn from this working balance in over 20 years, as of April 30, 1999. Consequently, the IMF's available and uncommitted resources may have been understated as of that date.

The Fund believes that it is necessary to maintain an amount of available and uncommitted resources that bears a reasonable relationship to its liquid liabilities to maintain the capacity of the Fund to meet its members' requests for their reserve positions. While the IMF does not consider its liquidity ratio to have a minimum level below which it should not fall, historically, the IMF has managed its resources in a way where this ratio has not fallen below 25 percent to 30 percent for an extended period. However, we found that the IMF had no formal methodology for deciding what the appropriate level should be; consequently, this threshold does not provide an analytical basis for determining whether the IMF's resources are constrained.

The IMF's Approach for Calculating Liquid Resources

To estimate the amount of its available and uncommitted resources, the IMF started with its total resources of about $287 billion as of April 30, 1999. This amount was then reduced by the amount of the IMF's holdings of unusable resources—$92 billion as of April 30, 1999. The remaining $195 billion, or 68 percent, was considered usable by the IMF. These usable resources consisted of (1) holdings of currencies of members considered by the Executive Board to have sufficiently strong balance-of-payments and reserve positions for their currencies to be used in IMF operations and (2) the IMF's holdings of SDR. The IMF considered $92 billion of its resources to be unusable to finance its transactions because as of April 30, 1999, they were

- currencies of members that were using IMF resources and were therefore in a weak balance-of-payments or reserve position;

- currencies of members with relatively weak external positions who may have drawn on their reserve tranche position but did not have outstanding loans from the IMF;
- gold holdings of the Fund that require an 85-percent vote by the Executive Board to be used and were not considered by the IMF as liquid resources; or
- other nonliquid assets, such as buildings and facilities.

After subtracting the unusable portion from its total resources, the IMF further reduced total usable resources for the amount of credit already extended to members in order to determine its available and usable resources. The IMF then reduced its available and usable resources by the amount of its estimates for commitments made and the minimum working balance reserve, as indicated in table 1.

Table 1: Calculation of the IMF's Available and Uncommitted Resources as of April 30, 1999

U.S. dollars in billions	
Total resources	$287
Less: unusable[a] resources	(92)
Total usable resources (before IMF extends credit)	195
Less: resources used (credit extended)	(82)
Available and usable resources	114
Less: commitments	(18)
Less: working balance reserve	(19)
Available and uncommitted liquid resources	$77[b]

Note: SDR exchange rate = $1.35123 for April 30, 1999, data.

[a]This includes currencies of members with relatively weak external positions, the IMF's gold holdings, and other nonliquid assets.

[b]Amounts do not add up due to rounding. The $77 billion in liquid resources gives the Fund a liquidity ratio of nearly 89 percent. The underpinnings for the IMF's liquidity threshold, which ranges between 25 percent to 30 percent, derives from its unique nature among the international financial institutions.

Source: The IMF.

Commitments represent lending arrangements in place to member countries needing financial assistance. A lending arrangement is a decision of the IMF by which a member is assured that it will be able to make purchases (drawings) from the General Resources Account (GRA) up to a specified amount and during a specified period of time, provided that the member observes the terms and conditions set out in the arrangement. Commitments reflect an estimate of undrawn loan balances through their expiration date (which can be up to 3 years) and 50 percent of precautionary arrangements.[19]

Deduction for Working Balances

The Fund's approach to estimating its available and uncommitted resources, as of April 30, 1999, included a deduction of $19 billion for maintaining a minimum working balance reserve. This working balance reserve is set at 10 percent of the quotas of members whose currencies are on the operational budget.[20] According to the IMF, it needs this working balance reserve to provide its members with specific currency denominations as requested. However, our analysis indicates that the IMF has not used this working balance reserve in over 20 years.

According to the IMF, a working balance reserve is needed because of the Fund's potential commitment to pay in specific currencies: (1) remuneration[21] to members, (2) payment commitments from IMF borrowing, and (3) requests from members who need foreign exchange to buy back their national currencies from other countries. However, we found that it was unlikely that the working balance reserve would be needed to meet these obligations. For instance, we found that since 1987, almost all members have requested that remuneration payments be made in SDR rather than in currencies. Members obtain a slightly higher level of earnings on their reserve tranche positions when they receive SDR rather than a specific currency as payment for remuneration because of the IMF's burden-sharing policy. (See app. IV for a description of burden-sharing.) As of April 30, 1999, the Fund held about $5 billion in SDR, which, according to

[19]The IMF makes precautionary arrangements to assist members interested in boosting confidence in the economic management of their country. Under such an arrangement, the member agrees to meet certain conditions in exchange for access to the IMF's resources but expresses its intention not to draw although it retains the ability to do so.

[20]The IMF does not publicly disclose the number of countries on its operational budget, but it tends to range between 20 to 35 countries. Quarterly, the IMF reassesses the financial strength and reserve positions of the members on the operational budget to determine if the members' currencies remain strong enough to be used or if other members' currencies have strengthened sufficiently to be included in IMF transactions.

[21]Remuneration is interest paid to a member for use of its currency.

the IMF, can also be used for working balances.[22] Thus, minimum working balances of specific currency denominations were not needed to pay remuneration as of April 30, 1999.

In addition, the second purpose of maintaining a working balance reserve is to repay any borrowings by the Fund in the specific currency borrowed. When the IMF accesses its GAB or NAB credit lines, it borrows directly from the participant providing the credit line and receives the currency of the participant. The IMF is obligated to repay any resources drawn from these credit lines in the same currency it borrowed.[23] Prior to 1998, the IMF had not activated its credit lines in 20 years. In July and December 1998, the IMF drew on the GAB and the NAB, respectively, borrowing about $6 billion in members' currencies. However, in March 1999, the IMF repaid both the GAB and NAB borrowings using U.S. dollars, SDR, and other currencies without using the working balance reserve.

Further, the IMF's third reason for maintaining a minimum working balance reserve is to provide particular currencies for special purposes, such as for a member to buy back balances of its national currency to intervene in currency markets under the Exchange Rate Mechanism (ERM).[24] This could happen if a member needed to acquire its national currency from another member who held a significant amount of the member's currency.[25] The last time that an industrial country made any reserve tranche position drawing for settlements under the ERM was in 1988. In the event that a reserve tranche position drawing for an industrial country is needed, the IMF has up to $46 billion in resources from its credit

[22] According to the IMF, its holdings of SDR were temporarily increased due to the recent quota increase and will be reduced to a target level between about $1.5 billion and $2 billion.

[23] "New Arrangements to Borrow, Paragraph 11, Repayment of the Fund." Under the instrument creating the NAB, the IMF "shall" repay in the participant's currency whenever feasible, in SDR or, after consultation with the participant, in convertible currencies.

[24] The ERM was a feature of the European Monetary System (EMS) by which EMS members agreed to maintain the relative prices of their currencies within narrow limits. This was done by keeping each country's value in European Currency Units within an agreed range of par values.

[25] Articles of Agreement, Art. V, Sec. 3 (d). The member could then draw on its reserve tranche position and obtain from the IMF the currency of the other member. The member would use the other member's currency to purchase its own currency from that member. The end result would be that the purchasing member would in effect be reducing the supply of its currency held internationally and, thus, could strengthen its own currency.

lines to accommodate such a request provided the conditions for the use of the credit line have been met.

Moreover, the IMF seeks to maintain a balance in the various types of currencies it holds to avoid the overuse of any particular currency. It does this by applying a systematic approach through its operational budget that allocates the specific currencies it plans to use to finance transactions and to receive for repayments. If a currency is overused, the IMF can discontinue use of this currency for disbursements and request that repayments be made in that currency to replenish the IMF's holdings of such currency to a level it considers acceptable. Due to this ability to manage the use and replenishment of specific currencies, the IMF is able to ensure that it retains sufficient levels of the various types of currencies it needs.

The most recent instance in which the IMF was unable to provide one of its members with the specific type of currency it wanted was in 1978. Even though the minimum working balance reserve policy had been established at 5 percent of quotas and totaled about approximately $3 billion in 1978, the Fund did not have sufficient amounts of yen and deutsche marks to provide to the United States, which needed about $5 billion worth of those currencies to strengthen the U.S. dollar following its depreciation. To obtain the needed currencies, the United States sold the equivalent of $2 billion of its SDR holdings and drew the equivalent of $3 billion from its reserve tranche position. Despite the IMF's policy, 5 percent of the quotas for Germany and Japan were not set aside as minimum working balances. Instead, the Fund provided yen and marks to the United States by activating the GAB credit lines with Japan and Germany. If in the future the IMF did not have enough of a specified currency on hand to meet a member's needs, the IMF could again activate its credit lines to obtain the specific currency denominations as it did in 1978.

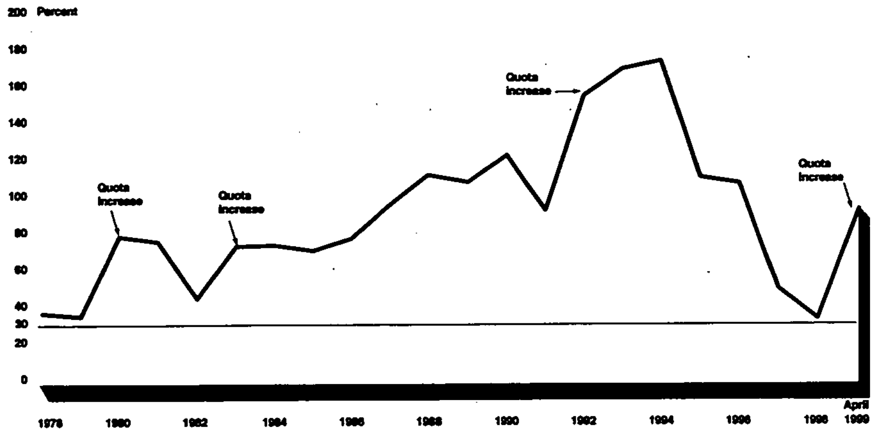
Basis for IMF's Liquidity Ratio Threshold

The IMF uses its liquidity ratio as a measure of the adequacy of its resources to meet members' financing needs, including a member's request to draw on its reserve tranche position. The IMF considers such a withdrawal to be the first claim on its resources, and as of April 30, 1999, this amounted to about $86 billion in potential claims, compared to $77 billion in available, uncommitted resources. According to the IMF, while it is difficult to project the probability that a member will draw on its reserve tranche positions at any particular time, the IMF must be in a position to meet any member's request for use of its reserve tranche position.[26] The IMF considers the likelihood that all of its liquid liabilities would be withdrawn over a short period of time to be relatively small. Between January 1999, when the quota increase went into effect, and April 30, 1999, 92 developing countries withdrew their reserve assets from the IMF. Such withdrawals totaled about $3.6 billion. (See app. I for further details.)

The Fund has managed its resources so that historically its liquidity ratio, the relationship between its available and uncommitted resources and its liquid liabilities, has not fallen below a 25-percent to 30-percent threshold for an extended period. The IMF uses the liquidity ratio as a benchmark of the adequacy of its resources. The IMF does not have a formal method to determine the appropriate minimum level of resources and the prevailing threshold was not based upon the IMF's analysis of variables that affect its liquidity. Such factors include members' historical reserve tranche drawings and/or forecasts of members' future reserve tranche drawings. Consequently, this liquidity threshold does not provide an analytical basis for determining whether the Fund's resources are, in fact, constrained. Moreover, the formula to calculate the liquidity ratio has changed four times in the last 20 years, further complicating the historical relevance of the ratio in IMF decision-making. (See fig. 1 for the IMF's liquidity ratio since 1978.)

[26]Articles of Agreement, Art. V, Sec. 3.

Figure 1: Trends in the IMF's Liquidity Ratio, December 31, 1978-98, and April 30, 1999



Note: The liquidity ratios were calculated using the formula that was operational at each date. The numbers have not been adjusted to reflect a consistent methodology over time. The date of IMF quota increases are reported to help explain periods where the liquidity ratio rose rapidly. The underpinnings for the IMF's liquidity ratio threshold derive from its unique nature among the international financial institutions.

Source: The IMF.

IMF Borrowing and Credit Lines

Historically, the IMF has borrowed to supplement its liquidity, but only from official sources. This has included member countries and their central banks, one country that was not a member at the time the funds were borrowed (Switzerland) and its central bank, and the Bank for International Settlements.[27] The Fund has not borrowed from private capital markets, although the IMF's Articles of Agreements permit it to do

[27]The Bank for International Settlement is an organization of central banks that is based in Basle, Switzerland. It is the principal forum for consultation, cooperation, and information exchange among central bankers.

so.[28] According to the IMF, the preference for borrowing from official rather than private sources reflects the nature of the Fund as a cooperative, intergovernmental institution whose basic purpose was to facilitate the overall adjustment process by making surpluses of some countries available to deficit countries.

The GAB[29] credit lines were established in 1962. The first drawing on the GAB was in 1964. In the 1970s, during periods of large payment imbalances, the IMF continued to use the GAB. In addition, the IMF began other official sector borrowings in the mid-1970s, and borrowing financed 45 percent to 62 percent of IMF credit between 1974 and 1979 and between 40 percent and 50 percent between 1980 and 1985. Since 1985, there has been a substantial decrease in borrowing, and there was no new borrowing between 1992 and 1997.

Borrowing resumed in July 1998, when about $2 billion was borrowed from the GAB to finance credit assistance to Russia. Also, in December 1998, about $4 billion was borrowed from the IMF's most recently established credit line, the NAB,[30] in connection with a 3-year credit arrangement with Brazil. Both of these amounts were promptly repaid by the Fund in March 1999, shortly after the IMF received funds from the recent quota increase. (See app. V for a more detailed description of IMF borrowing.)

The IMF's Gold Holdings

The IMF held a reserve of about 103 million fine ounces of gold with a market value of about $30 billion as of April 30, 1999.[31] This gold was largely acquired through members' quota reserve payments that up until the early 1970s had to be made in gold. With the end of the gold standard in

[28]Articles of Agreement, Art. VII, Sec. 1 (i). However, a member can object to its currency being borrowed from whatever source.

[29]The GAB is an arrangement of credit lines that the IMF maintains with the Group of 10 Industrialized Countries (G-10) for use in emergencies. The G-10 originally comprised 10 industrialized countries: Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, the United Kingdom, and the United States. Switzerland became the 11th member in 1984.

[30]The NAB is an enlarged version of the GAB with 25 members. Together, GAB and NAB had a combined total of about $46 billion as of April 30, 1999.

[31]As of August 30, 1999, the market value of the Fund's gold holdings had declined to about $26 billion.

the early 1970s and the passage of the second amendment to the IMF's Articles of Agreement in April 1978, gold's formal role in the IMF and international currency transactions was eliminated. While a formal role for gold no longer exists, current IMF policy stresses the importance of gold as a reserve for the IMF. In 1995, the IMF's Executive Board reviewed the IMF's position on holding gold as a reserve asset and established several governing principles for managing its gold reserves. These principles state that

- gold provides a "fundamental strength" to the IMF;
- gold provides operational maneuverability in the IMF's use of its resources and adds credibility to its precautionary balances;
- gold should be held to meet unforeseen contingencies;
- the IMF has a responsibility to avoid disruption to the functioning of the gold market; and
- profits from gold sales should be retained and invested, and only the income from such investments should be used for agreed-upon purposes such as providing balance-of-payment assistance to developing nations.

The IMF continues to view gold as a valuable reserve asset despite events over the past 10 years suggesting that a consensus on this point among official holders[32] has begun to weaken. Several official government holders of gold have sold a portion of their holdings, and an estimated 80 official holders have lent their gold to the private market to earn a return on their holdings. Since the mid-1970s, the Fund has only considered or allowed gold sales to support specific balance-of-payment or debt relief proposals. The "opportunity costs" associated with this policy are significant. For example, in 1995, the IMF examined the effect of its decision to hold its stock of gold. The decision to hold gold instead of selling it and investing the sales proceeds has resulted in tens of billions of dollars of foregone realized gains and investment income.

The Size and Value of the IMF's Gold Holdings

The IMF values its gold at SDR 35 per fine ounce (about $47 per fine ounce as of April 30, 1999), its value at the time of acquisition. Therefore, the IMF's gold holdings were valued on its balance sheet at SDR 3.6 billion (about $5 billion). However, the IMF reported in a footnote to its financial

[32]The United States, the official holder with the largest amount of gold reserves, continues to view gold as a valuable reserve asset.

statements the market value of its gold holdings as of its financial year-end. On April 30, 1999, the IMF estimated its gold had a market value of about $30 billion.

The IMF treats gold as a "nonliquid" resource that is generally not available to finance its operations. Gold is considered nonliquid by the IMF because mobilization of this resource must be approved by 85 percent of the Executive Board's total voting power. As a result of this fact and the length of time required to dispose of gold reserves without significantly disrupting the financial markets, gold cannot be easily used to meet near-term financial crises.

The IMF has determined that ownership rights to the Fund's gold reside with the IMF.[33] Under the IMF's Articles of Agreement, members may have residual rights to the gold in two instances: if the Fund elects to restitute[34] gold to members or to liquidate the Fund. In the first instance, gold could be restituted to all countries that were members on August 31, 1975, based on their quotas at that time.[35] In the latter case, gold may be distributed to members on the same basis after the Fund's liabilities have been satisfied.[36] If the IMF elected to restitute its current stock of over 100 million fine ounces of gold, the United States would receive almost 24 million fine ounces of gold based on the formula described in the Articles.

The IMF's gold holdings have fluctuated over time, peaking in the 1972-75 period when the Fund held a total of about 153 million fine ounces of gold. By 1980, the IMF's total gold holdings had dropped to the current level of 103.4 million fine ounces.[37] No sales of gold have occurred since May 1980. The IMF's gold holdings since the Fund's inception are shown in figure 2. The large increase in gold holdings between 1969 and 1970 (from about 66 million ounces to 124 million fine ounces) is due to the relatively large fifth general quota increase and the repurchase of gold that had been

[33]IMF Executive Board, Dec. No. 170-3 (5/20/47).

[34]According to the IMF, the term "restitute" describes the sale of the IMF's gold holdings to members at the official price of SDR 35 per fine ounce instead of at market rates.

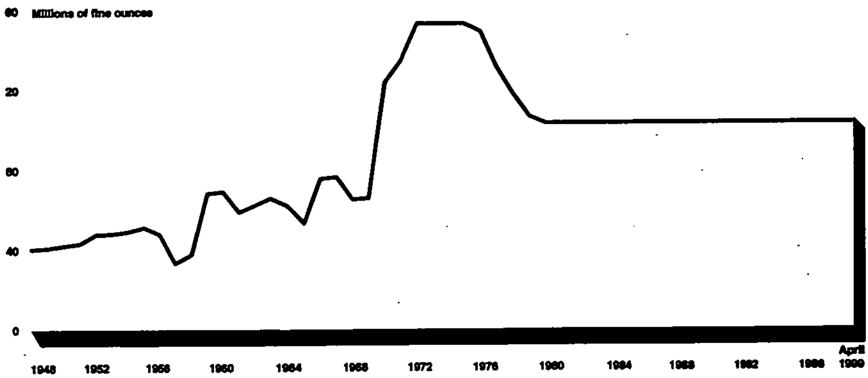
[35]Articles of Agreement, Art. V, Sec. 12 (e).

[36]Articles of Agreement, Schedule K.

[37]In 1992, the Fund accepted 21,396 fine ounces of gold from Cambodia as payment for repurchase obligations.

previously sold to the United States. Appendix II provides additional details on the sources and uses of the Fund's gold holdings.

Figure 2: The IMF's Gold Holdings, 1948-April 30, 1999



Source: The IMF's *International Financial Statistics*.

Trends in Gold Reserve Management Practices

For almost a 20-year period after the United States left the gold standard in 1971, official holders of gold preferred to hold gold as a reserve asset rather than dispose of their gold holdings, including the United States, which has monetized but not sold its gold holdings.[38] Beginning in 1988, this consensus began to weaken among certain official holders, with the sale of official gold holdings by Canada.[39] These sales were followed by gold sales and gold leasing by several additional countries, including the most recent sale of official gold by Great Britain in July 1999. Other sellers include Argentina, Australia, Belgium, the Czech Republic, and the Netherlands. In addition, a recently approved referendum in Switzerland, which removed the Swiss franc from the gold standard, has opened the possibility for a Swiss sale of an estimated 1,300 tons (about 42 million fine ounces) of gold, or over half of its national reserve.

An Estimate of the Cost of Holding Gold

The IMF has continued to examine various scenarios on the possible use of gold to produce income for the Fund taking into account its Articles, which place certain restrictions on the sale of gold. In addition, the IMF interprets its Articles as precluding the trading of gold by the Fund. According to one scenario, if the IMF sold 6 million fine ounces of gold each year from May 1980 to December 1996 (when the stock of the IMF's gold would have been fully depleted), and the proceeds were invested in financial instruments yielding the SDR rate of interest, the IMF would have received tens of billions of dollars in realized gains and investment income. Since gold prices fluctuate and have declined since the mid-1990s, the Fund may realize less now if it sold its gold than it would have realized at an earlier date, but the amount would still be in the billions of dollars.

Process for Determining the IMF's Quota Resources

The IMF's Eleventh General Review of Quotas began on August 9, 1995, and was completed on January 30, 1998, when the Board of Governors adopted a resolution proposing to increase the total of IMF quotas by 45 percent from SDR 146 billion to SDR 212 billion (about $288 billion). During this process, IMF staff provided quantitative analyses of various factors to the Executive Board for its consideration and recommended that the size of the quotas be increased by 100 percent as a result of those factors. IMF documents showed that the executive directors examined the staff's

[38]The Secretary of the Treasury is authorized to issue gold certificates to the Federal Reserve, which then issues an equivalent credit (at the official price of gold) to a Treasury deposit account. The 1998 *Financial Report of the United States* notes that $11 billion of the U.S. gold reserves of 262 million fine ounces has been monetized in this fashion.

[39]Canada reduced its official gold reserve from 17 million ounces to 4 million ounces, between 1988 and 1995.

analyses and recommendation but did not reveal any alternative analytical basis on which the Executive Board's recommendation to the IMF's Board of Governors for a 45-percent increase was made. From the early stage of the review process, most directors had favored a much higher increase than 45 percent and had maintained that position through April 1997. However, between June 1997 and September 1997, a consensus was reached among the executive directors on the 45-percent increase and on the manner in which the increase would be distributed.

The IMF has never formally adopted a method for determining members' initial quotas and subsequent quota increases because it believes that quantitative measures cannot fully reflect the considerations that appropriately bear on each member's position or on the total size of the Fund's resources. Both the staff and the Executive Board have acknowledged that many of the factors that influence the size of the IMF's quotas are difficult to quantify. These factors include the prospective demand for IMF resources, the growth of world trade, and the trend in the IMF's liquidity position. In addition, the Executive Board takes into consideration the political feasibility of getting approval for the quota increase from the IMF's member governments. Consequently, the process for determining the size of the quota increase and the distribution among the IMF's members involves a great deal of judgment on the part of the Executive Board.

Although the distribution of quotas among the members determines the share of voting power in the IMF, the member's representation on the Executive Board, and the amount members can borrow from the Fund,[40] these issues were not a major source of debate in the Eleventh General Review. Most of the executive directors had agreed early in the quota review process that the distribution should be predominantly equiproportional,[41] thus maintaining the quota structure. However, there were considerable differences of opinion on the share of selective increases to be included in the total as well as on the distribution method to

[40]The amount of funds that a member may borrow from the IMF is typically limited to a certain percentage of that member's quota.

[41]Equiproportional increases are allocated based on a uniform percentage for members participating in the review. They are allocated irrespective of members' relative positions in the world economy and by definition, tend to maintain historical shares in quotas.

be used.[42] In the end, the quota structure remained essentially unchanged, and the Eleventh General Review's increase was distributed based on an equiproportional element of 75 percent, a selective element of 15 percent, and an ad hoc element of 10 percent.[43] The selective element was distributed in proportion to members' shares, based on the quota calculations of IMF staff.[44] The ad hoc element focused on those members whose quotas were farthest out of line with their relative economic positions. A discussion of the history of the IMF's quota review process is provided in Appendix III.

The Evolution of IMF Lending

Since 1945, the IMF's GRA lending has evolved due to global events and to meet its member countries' needs. The GRA arrangements have expanded from short-term currency purchases for balance-of-payment problems to nine types of arrangements and facilities that have tended to have longer repayment periods. These changes came largely in response to the shift in the IMF's lending from a mix of industrialized and developing countries to developing countries only.

Developments in the IMF's Lending

As indicated in figure 3, industrial countries comprised about half of the total amount of the IMF's GRA outstanding credit from 1947 through 1977. However, industrial countries use of IMF resources decreased rapidly, and by 1988, all users of IMF resources were developing countries. The main cause of this change over time is that industrial countries developed increased access to funds provided by financial markets to satisfy their external financing requirements. However, many developing countries do

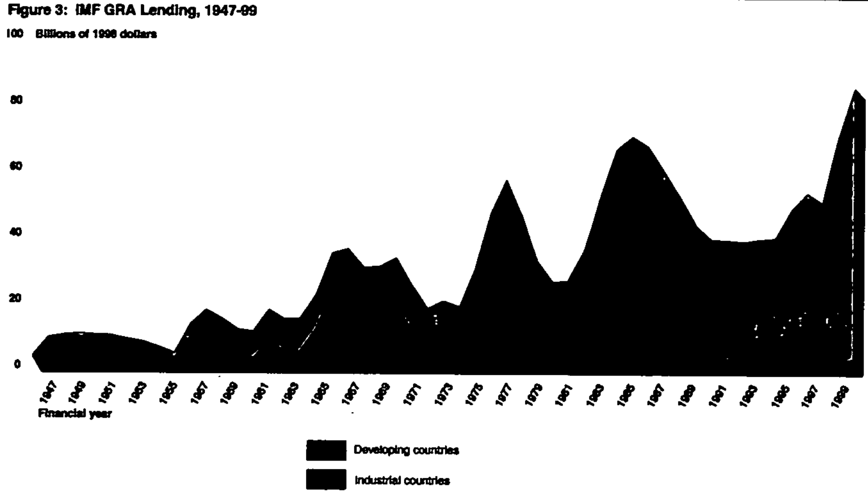
[42]The various methods include: Method A, which allocates the selective element in proportion to members' shares in calculated quotas; Method B, which distributes the selective increase to only those members, or subset of members, whose shares in calculated quotas exceed their shares in present quotas; and Method C, which combines Method A with a technique providing for a further (selective) increase in quotas that becomes progressively larger as the discrepancy between the member's shares in calculated and actual quotas becomes larger.

[43]In a voluntary redistribution of quota shares, the quotas of France and the United Kingdom were equalized, as established in an agreement reached under the Ninth General Review, and there was a further reallocation of the quotas of Italy and Germany.

[44]The quota calculations are based on formulas, which take into account each member's GDP, current payments and receipts, variability of current receipts, and reserves.

not have sufficient access to capital markets, particularly in periods of financial distress, and continue to rely upon the IMF for financial support.

Figure 3: IMF GRA Lending, 1947-99



Source: GAO analysis of IMF annual reports amounts adjusted to 1998 U.S. dollars.

Since 1947, the IMF's GRA lending has involved increasingly larger amounts of financial assistance in response to the needs of its members, as follows:

- From 1947 through 1975, the level of GRA lending was low and consisted primarily of currency purchases for balance-of-payments assistance, with many transactions paid in gold. The first lending peak of about $33 billion (in 1998 U.S. dollars) as of April 30, 1967, reflected a high demand for balance-of-payments assistance particularly by the United Kingdom, which accounted for about 55 percent of the outstanding GRA credit.

- From 1976 through 1982, the level of GRA lending was moderate, with an expansion of the types of lending facilities and the end of the gold standard in 1978. A second lending peak of about $54 billion (in 1998 U.S. dollars) as of April 30, 1977, was due to Oil Facility loans made in response to the worldwide oil crisis of 1974-75, which accounted for about 33 percent of the outstanding GRA credit.
- Since 1983, the level of GRA lending has been high, with a further expansion of the types of lending facilities and several world events requiring extensive IMF economic assistance. This included a third lending peak of about $67 billion (in 1998 U.S. dollars) as of April 30, 1985, for economic assistance to Latin America during its debt crisis of 1983-90, which accounted for approximately 38 percent of the outstanding GRA credit. The fourth lending peak of $82 billion as of April 30, 1999, reflected a high demand for lending to Indonesia, Korea, and Thailand in response to the 1997 Asian financial crisis and large borrowings by Brazil, Mexico, and Russia. These six countries accounted for about 73 percent of outstanding GRA credit.

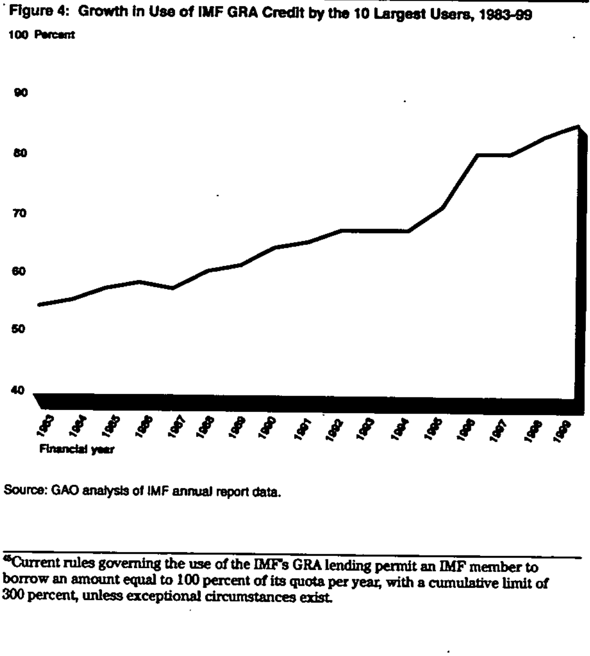
Since 1947, the IMF has increased the number of its GRA lending arrangements and facilities in response to the increased demand for credit. This included an expansion of lending arrangements and facilities from currency purchases for short-term balance-of-payment problems to assistance for longer term structural balance-of-payment problems. Fund facilities grew to address shortfalls in export earnings, to finance oil purchases and other imports, to provide assistance to low-income countries, to fund the transition from centrally planned economies to market-based economies, and to give financing for exceptional balance-of-payment problems that could threaten the international monetary system.

With the expansion of IMF lending facilities, repayment terms have also tended to lengthen. This was due to greater extended fund arrangements and assistance to countries in transition to market-based economies. An exception to this trend was the creation of the Supplemental Reserve Facility (SRF) in 1997, with a repayment period of between 1 and 2-½ years.

Lending Concentration, Borrowing Limits, and Arrears

As the IMF's lending has shifted exclusively to developing countries, its lending portfolio has become more concentrated among fewer borrowers. In addition, a number of borrowers have exceeded the IMF's normal limits permitting a member to borrow up to a certain percentage of the member's quota.[45] Further, some members have been unable to meet their obligations to the Fund when due. As indicated in figure 4, the percentage of the IMF's GRA lending held by the 10 largest borrowers has grown steadily since 1983. The 10 largest users of IMF's GRA lending accounted for 55 percent of total GRA credit outstanding as of April 30, 1983. This percentage has steadily increased to 86 percent of total GRA credit outstanding as of April 30, 1999, among the highest levels in IMF history. One country, Russia, a borrower since 1993, accounted for 21 percent of total GRA credit outstanding as of April 30, 1999. See appendix IV, table 6, for a further discussion of the 10 largest GRA borrowers from 1983 to 1999.

Figure 4: Growth in Use of IMF GRA Credit by the 10 Largest Users, 1983-99



Source: GAO analysis of IMF annual report data.

[45]Current rules governing the use of the IMF's GRA lending permit an IMF member to borrow an amount equal to 100 percent of its quota per year, with a cumulative limit of 300 percent, unless exceptional circumstances exist.

The limits as to the amount of funds that a member may borrow from the IMF were last changed in 1994, when the yearly limit on borrowing was increased from 68 percent of quota to 100 percent. In the past 4 years, the IMF has provided financing to five large developing countries that have experienced financial crises. This financing was in amounts that were all well in excess of the IMF's limit on cumulative borrowing (see table 2).

Table 2: IMF Borrowing Arrangements That Exceeded 300 Percent of Quota, as of April 30, 1999

Dollars in billions

Member	Arrangement date	Amount of arrangement	Percent of quota
Mexico	1995	$17.9	688
Thailand	1997	3.9	500
Indonesia	1997-98	11.4	557
Korea	1997	21.0	1940
Brazil	1998	18.3	600

Source: GAO analysis of IMF data.

IMF officials have stated that the IMF has never had a lending default or write-off since its inception. However, since 1983, 15 IMF members have been unable to meet their obligations to the GRA when due.[46] Prior to this time, only Cambodia had experienced protracted arrears to the Fund. Arrears totaled about $26 million from one member as of April 30, 1983, and reached a high of $4.5 billion from nine members as of April 30, 1992. In response to this situation, the IMF took various measures intended to reduce arrearages, increase repayments, and protect the Fund's financial position. These measures included

- declaring members ineligible for further lending until arrears are cleared,

[46]The 15 countries are Cambodia, Guyana, Vietnam, Liberia, Sudan, Peru, Zambia, Sierre Leone, Somalia, Honduras, Panama, Democratic Republic of Congo, Haiti, Bosnia/Herzegovina, and Serbia/Montenegro. See appendix IV for additional details regarding these countries' arrears.

- adopting a burden-sharing mechanism that created additional funds to share the cost of overdue obligations to the IMF between debtors and creditors,
- developing a Strengthened Cooperative Strategy (including a rights accumulation program)[47] that included communications with international financial institutions if a member fails to fulfill its financial obligations to the Fund,
- issuance of a public declaration of noncooperation[48] when a member does not actively cooperate with the Fund,
- suspending the voting rights of members in arrears to the Fund, and
- requiring compulsory withdrawal of members from the IMF who fail to clear their arrears.

Due to the measures taken by the IMF and through financial assistance provided by some countries, as of April 30, 1999, only five members were in arrears to the GRA, owing about $2.8 billion.[49] In addition, none of the other 10 members formerly in arrears have incurred any subsequent arrears. The principal amount owed by these five members of about $1.5 billion constituted less than 2 percent of the IMF's GRA credit outstanding as of April 30, 1999. Additionally, four of these members were declared ineligible for further IMF lending,[50] three were issued declarations of noncooperation,[51] two have had their voting rights suspended,[52] and one member is under consideration for compulsory withdrawal from the Fund as of April 30, 1999.[53]

[47]The rights accumulation program enables a member to accumulate rights to draw upon the IMF's resources after clearing its arrears and is limited to the 11 countries in protracted arrears as of the end of 1989. (See app. IV for a further discussion of the IMF's burden-sharing mechanism.)

[48]A declaration of noncooperation is a prelude to suspending the member's voting rights.

[49]The five countries are Congo (DRC), Liberia, Somalia, Sudan and the portion of the former Yugoslavia pertaining to Serbia/Montenegro.

[50]The four countries are Congo (DRC), Liberia, Somalia, and Sudan.

[51]The three countries are Congo (DRC), Liberia, and Sudan. In August 1999, the IMF lifted the declaration of noncooperation for Sudan.

[52]The two countries are Congo (DRC) and Sudan.

[53]The country is Sudan.

In response to its problems with arrears, the IMF increased its reserves for potential loan losses, known as "precautionary balances," from about $1.1 billion as of April 30, 1983, to about $6.2 billion as of April 30, 1999. This included the adoption of "burden- sharing" in 1986 as a system of providing resources to increase precautionary balances to share the cost of overdue obligations between debtor and creditor members.

Status of the IMF's and Its Members' Year 2000 Computer Compliance

The Year 2000 problem could affect nearly every aspect of the international financial system—from the ability of internal systems that support IMF operations to function properly to the ability of member nations to repay loans. While the IMF recognizes the importance of the impact that the problem may have on its mission-critical systems and has taken steps to mitigate potential damage, it still faces some challenges in providing more complete assurance that its internal business processes will continue to function after the date change. Further, IMF needs to complete its assessment of the impact of Year 2000 failures on the potential for increased demand for financing by its members.

IMF's Internal System Status

IMF officials stated that they have identified three systems as being mission critical[64] and believe that all three will be Year 2000 compliant by January 1, 2000. IMF is currently working on developing contingency plans for all three systems and expects to have them complete by the end of September 1999. Our Year 2000 business continuity and contingency planning guidance—also adopted by Office of Management and Budget—stresses the importance of good business continuity plans to minimize the risk of system failures on core business processes. We recommended that such plans be prepared by April 30, 1999, and tested by September 30, 1999.

While the Fund states that it is on target to test the plans by September 30, these plans may not account for all key processes. For example, Fund officials told us that the IMF has not completed assessment of its "user-developed systems" to determine which, if any of these systems, generate data for input into the mission-critical systems. However, they plan to complete this assessment and report on the results before the end of the year. By completing the assessment so late in the year, IMF will not be fully

[64]These systems include the financial and administrative system, the member country account system and the payroll system.

aware of any problems until after the date change—too late to take preemptive action.

Member Nation Assessment

The IMF has only recently started to assess the Year 2000 status of its 182 member nations, and the impact that any problems faced by these members may have on IMF operations. Such problems could range from isolated failures in individual computer systems to larger, more debilitating, failures of critical infrastructure processes affecting transportation, public utilities, or financial operations. Such failures could in turn generate demand for additional financing and/or extensions in IMF repayment terms.

The IMF was slow in recognizing the potential impact and, in turn, was slow to initiate such an assessment. Officials told us that IMF delayed action because it believed that the issue was best addressed by the World Bank because it was better positioned to provide technical assistance. However, after the Fund conducted a Year 2000 seminar of the importance of member countries' compliance in April 1999, IMF officials became convinced that there were economic issues involved that could impact the Fund. Shortly afterward, an IMF-World Bank team was established to identify the countries that will not be compliant, the resulting impact on the IMF, and the contingency plans for worst-case scenarios. IMF officials do not know when the team will complete its work but do expect an interim report in the near future.

Depending on the results of the study, the late start by the IMF-World Bank team could limit the Fund's ability to effectively plan for actions that could limit the impact on its existing loan portfolio and position the IMF to offer more financial assistance to impacted nations.

Agency Comments and Our Evaluation

We requested comments on a draft of this report from the Department of the Treasury and from the International Monetary Fund. A senior Treasury official provided oral comments on behalf of Treasury and the IMF. These comments characterized our report as providing a comprehensive examination of the significant issues affecting IMF's financial condition that should be informative and useful to most readers. In addition, both the IMF and the Treasury provided technical and clarifying comments, which we incorporated where appropriate.

We are sending copies of this report to the Honorable Lawrence Summers, Secretary of the Treasury; the Honorable Madeleine K. Albright, Secretary of State; the Honorable Jacob Lew, Director, Office of Management and Budget; and the Honorable Michel Camdessus, Managing Director, IMF. Copies will be made available to others upon request.

This report was prepared under the direction of Harold J. Johnson, Associate Director, International Relations and Trade Issues, and Gary T. Engel, Associate Director, Governmentwide Accounting and Financial Management Issues. Please contact either Mr. Johnson at (202) 512-4128 or Mr. Engel at (202) 512-8815 if you or your staff have any questions about this report. Other key contacts and staff acknowledgments are in appendix VII.

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House of Representatives

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Ranking Minority Member
Committee on Appropriations
House of Representatives

Appendix I

The IMF's Liquid Resources and Liquidity Position

The liquid resources of the International Monetary Fund (IMF) consist of national currencies and Special Drawing Rights (SDR).[1] Not all of the national currencies held by the IMF are usable all the time (that is, strong enough to be lent to other members). As of April 30, 1999, of the IMF's $287 billion in resources, $195 billion (68 percent) was considered usable by the IMF. National currencies constituted $190 billion of usable resources, and the IMF's SDR holdings made up the remainder.[2] The IMF monitors the usability and actual use of the currencies through semiannual liquidity reviews and through its quarterly operational budget. Currencies are selected for the operational budget on the basis of an assessment of each member, using a range of indicators including members' balance of payments, members' reserve positions, and developments in exchange markets. As of April 30, 1999, the United States was the single largest contributor of usable resources, contributing 26 percent (about $51 billion) of the IMF's total usable resources.

Over the past 20 years, the amounts of the IMF's usable and unusable resources have varied, as indicated in figure 5. Usable resources over the period averaged about 60 percent of total resources, with a significant portion coming from the G-10.[3] During this period, the United States was the major contributor of usable resources, except during 1978 and 1979 when the dollar was not considered strong enough to be used to finance the IMF's transactions and, accordingly, was excluded from the IMF's operational budgets.[4]

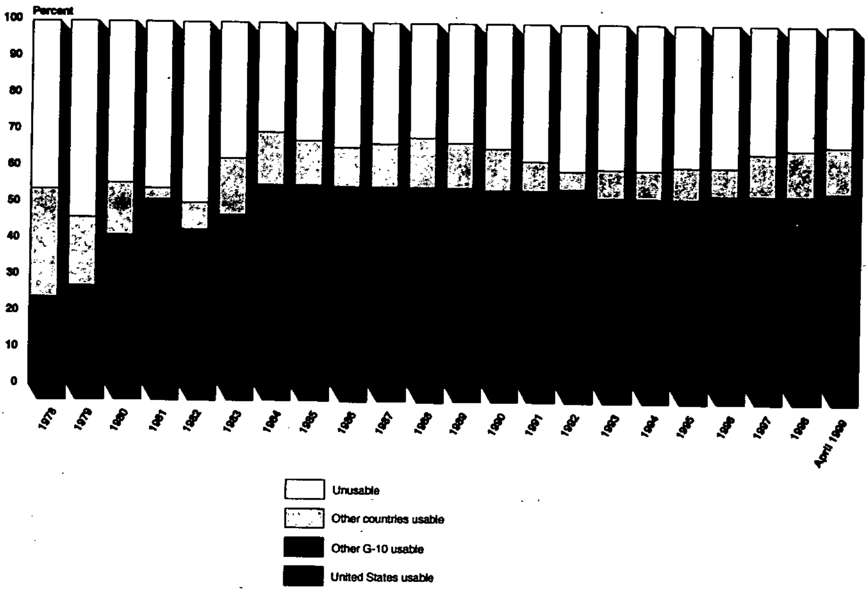
[1]The SDR is a reserve asset that IMF has used since 1969. Its value comprises a weighted average of the values of four currencies: the U.S. dollar, yen, euros, and pound sterling. Because the value of the SDR relative to these currencies changes daily, the U.S. dollar value of amounts converted from SDR also changes daily. The SDR is the unit of account for the Fund.

[2]SDR can be held by, but not allocated to, the General Resources Account (GRA) of the IMF. The GRA receives SDR in partial payment of quotas, from charges on the use of IMF resources, and from repurchases.

[3]The G-10 originally comprised 10 industrialized countries: Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, the United Kingdom, and the United States. Switztzerland became the 11th member in 1984.

[4]Following the depreciation of the U.S. dollar in the fall of 1978, the United States mobilized resources, including $5 billion from the IMF, to defend the dollar.

Figure 5: The IMF's Usable and Unusable Quota Resources, End of Calendar Years 1978-98 and April 30, 1999



Source: GAO analysis of IMF data.

Members' Use of Reserve Tranche Position From the Latest Quota Increase

Table 3 identifies 92 countries that, by April 30, 1999, had withdrawn their entire $3.6 billion of reserve tranche contributions from the January 1999, quota increase. This withdrawal reduced by about 17 percent the amount of usable resources obtained through contributions of reserve assets from the most recent quota increase.

The IMF's Eleventh General Review's quota increase of $89 billion became effective in January 1999. As of April 30, 1999, $84 billion had been paid by members, including 25 percent in usable currencies or SDR, totaling about $21 billion. Included in this amount were the 92 developing countries that had paid their quota subscription of about $14 billion, including 25 percent in reserve assets of usable currencies or SDR, totaling about $3.6 billion. Between January 1999, when the Eleventh General Review quota became effective, and April 30, 1999, these 92 members withdrew the entire $3.6 billion of usable currencies or SDR, replacing them with their national currencies.

Table 3: Eleventh General Review's Quota Increase and Related Reserve Tranche Drawings Through April 30, 1999, for Certain Members

Dollars in millions

Country	Eleventh General Review's quota increase	Reserve tranche contribution and withdrawal (25 percent of quota increase)
Angola	$107	$27
Antigua & Barbuda	7	2
Argentina	784	196
Azerbaijan	59	15
Bangladesh	190	48
Belarus	143	36
Benin	22	6
Bolivia	61	15
Bosnia & Herzegovina	65	16
Brazil	1,169	292
Bulgaria	237	59
Burkina Faso	22	5
Burundi	27	7
Cambodia	30	8
Cameroon	68	17
Cape Verde	4	1
Central African Republic	20	5
Chad	20	5
Comoros	3	1
Congo, Republic of	36	9
Cote d'Ivoire	118	29

Continued

Dollars in millions

Country	Eleventh General Review's quota increase	Reserve tranche contribution and withdrawal (25 percent of quota increase)
Croatia	$ 140	35
Czech Republic	310	78
Dominican Republic	81	20
Ecuador	112	28
El Salvador	62	15
Equatorial Guinea	11	3
Eritrea	6	1
Ethiopia	48	12
Gabon	59	15
Gambia, The	11	3
Georgia	53	13
Guinea	38	10
Guinea-Bissau	5	1
Guyana	32	8
Iran, Islamic Republic of	566	141
Jamaica	98	25
Jordan	66	16
Kazakhstan	160	40
Kenya	97	24
Kiribati	2	1
Kyrgyz Republic	33	8
Latvia	48	12
Lesotho	15	4
Lithuania	55	14
Macedonia, former Yugoslav Republic of	26	7
Madagascar	43	11
Malawi	25	6
Mali	33	8
Mauritania	23	6
Mexico	1,125	281
Moldova	45	11
Mongolia	19	5
Mozambique	40	10
Myanmar	99	25
Nepal	26	7

Continued from Previous Page

Dollars in millions

Country	Eleventh General Review's quota increase	Reserve tranche contribution and withdrawal (25 percent of quota increase)
Nicaragua	$ 46	11
Niger	24	6
Nigeria	637	159
Pakistan	372	93
Palau	1	a
Panama	77	19
Papua New Guinea	49	12
Peru	233	58
Philippines	333	83
Romania	373	93
Russian Federation	2,206	551
Rwanda	28	7
Sao Tomé & Príncipe	3	1
Samoa	4	1
Senegal	58	14
Seychelles	4	1
Sierra Leone	36	9
Slovak Republic	135	34
Solomon Islands	4	1
South Africa	680	170
St. Kitts and Nevis	3	1
St. Lucia	6	1
Syrian Arab Republic	113	28
Tajikistan	36	9
Tanzania	70	18
Thailand	686	172
Togo	26	6
Trinidad & Tobago	120	30
Uganda	63	16
Ukraine	506	127
Uzbekistan	103	26
Vanuatu	6	2
Vietnam	118	30
Yemen, Republic of	91	23
Zambia	170	42

Continued from Previous Page

Dollars in millions

Country	Eleventh General Review's quota increase	Reserve tranche contribution and withdrawal (25 percent of quota increase)
Zimbabwe	$ 124	31
Total	$14,348	$3,587

Continued from Previous Page

[a]Less than $1 million.

Note: SDR exchange rate = $1.35123 as of April 30, 1999.

Source: GAO analysis of IMF's *International Financial Statistics*.

Appendix II

The IMF's Gold Holdings

From the IMF's inception through the passage of the second amendment to the IMF's Articles of Agreement in 1978, gold played an important role in the Fund's operations and the operations of the international monetary system. However, with the end of the gold standard in the early 1970s and the passage of the IMF's second amendment in April 1978, gold's formal role in the IMF and international currency transactions was eliminated.[1] Among other changes, the second amendment abolished the official price for gold, eliminated its use as the common denominator in the par value system,[2] and removed the obligatory use of gold in transactions between the IMF and its members. The second amendment anticipated a greatly diminished role for gold while seeking to promote an enhanced role for the SDR, which was intended to replace gold as the world's principal reserve asset.[3]

The Articles of Agreement specify that, based on an 85-percent majority vote of the total voting power of the Executive Board, the IMF may sell its gold and it may accept gold, at market prices, in discharge of members' obligations to the Fund.[4] According to an IMF official, the Fund is not authorized to engage in any other gold transactions—including loans, leases, or use of gold as collateral—because these uses are not expressly allowed under the Articles of Agreement. More specifically, IMF documents note that the Articles of Agreement permit only the transfer of ownership rights to the gold for a price. According to IMF officials, because loans, leases, swaps, or the use of gold as collateral do not require a permanent transfer of ownership rights, they are not permitted under the Articles of Agreement.

[1] In August 1971, the United States announced that it would no longer buy and sell gold at the official rate. This announcement was followed by the effective breakdown of the Bretton Woods par value system, with the devaluation of the U.S. dollar in December 1971, and by the generalized floating of exchange rates in March 1973.

[2] Before the breakdown of the Bretton Woods system in the early 1970s and the subsequent amendment of the Articles, the value of each member's currency was expressed in terms of gold (par value) or against the U.S. dollar, which was convertible to gold at $35 per fine ounce.

[3] In the face of the development of worldwide currency exchange markets, the SDR has never achieved the preeminence anticipated by the IMF.

[4] Articles of Agreement, Art. V, Sec. 12(b)

When the IMF sells gold, the original capital value of the gold of SDR 35 per fine ounce is deposited in the GRA[5] and becomes immediately available for the general operations of the IMF. Gold sale profits (that is, the sale price above the capital value of the gold) are generally deposited in a separate account, called the Special Disbursement Account (SDA),[6] which provides the primary financial framework for handling such profits. Gold sale profits in the SDA may be transferred to specialized accounts (such as the Enhanced Structural Adjustment Facility-Heavily Indebted Poor Country (ESAF-HIPC) Reserve Trust Account) or they may be transferred to the GRA for use in the IMF's general operations.[7]

Specifically, the Articles of Agreement state that, based on majority votes by the Executive Board, assets held in the SDA may be used[8]

- to make transfers to the GRA for immediate use in the IMF's operations (70 percent of total voting power required);
- for operations and transactions that are not authorized by other provisions of the Articles of Agreement but are consistent with the purposes of the IMF, including balance-of-payments assistance to developing members (85 percent of total voting power required);
- for proportionate distribution of resources authorized for the purpose of providing balance-of-payments assistance to those developing members that were members on August 31, 1975, based on their respective quotas on that date (85 percent of total voting power required); and

[5]Articles of Agreement, Art. V, Sec. 12(f). Most transactions between member countries and the IMF take place in the GRA. This account handles, among other transactions, the receipt of quota subscriptions, purchases and repurchases, interest payments to members, and repayments of principal to the IMF's lenders.

[6]Articles of Agreement, Art. V, Sec. 12(f). The Special Disbursement Account is established to receive and invest profits from the sale of IMF's gold (that is, the net proceeds in excess of the book value of SDR 35 per fine ounce); and make transfers for special purposes authorized in the Articles of Agreement. As of April 30, 1999, the balance in the SDA totaled about $924 million.

[7]Articles of Agreement, Art. V, Sec. 12(f) (i to iii). In June 1999, the Group of Seven (G-7) countries proposed in Cologne, Germany that the IMF to sell up to 10 million fine ounces of its gold holdings and to use the investment income from those profits to help finance the IMF's contribution to poor country debt relief. The G-7 consists of the seven major industrial countries (Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States) that consult on general, economic, and financial matters.

[8]Articles of Agreement, Art. V, Sec. 12(f).

- to transfer SDA resources to the investment account (85 percent of total voting power required).[9]

Resources in the SDA, investment account, and specialized trust fund accounts (such as the ESAF-HIPC Reserve Trust Account) may be invested in income-producing securities of members or of international financial organizations.[10]

Gold Acquisition Sources and Uses

The IMF acquired almost all of its gold prior to January 1, 1974, through a variety of means. The highest amount of gold holdings occurred in the mid-1970s, when the IMF held 153 million fine ounces of gold.

Specific acquisition sources for the IMF's gold holdings include the following:

- *Quota subscriptions.* The original Articles of Agreement prescribed that 25 percent of initial quota subscriptions and quota increases were normally to be paid in gold. This represented the largest source of the IMF's gold holdings.
- *Payment of charges.* Originally, all charges, that is, interest on members' outstanding use of IMF credit, were normally payable in gold.
- *Repurchases.* Members were permitted—and in some circumstances could be required—to use gold to repay the IMF for credit previously extended.
- *Purchases.* A member wishing to obtain the currency of another member could acquire it by selling gold to the IMF.

From 1976 through 1980, the IMF reduced its gold holdings by one-third but has not disposed of any gold since then. Sales of gold on the open market or restitution of gold to the members has been used for a variety of purposes, such as the following:

[9] Articles of Agreement, Art. V, Sec. 12(g). The IMF has never activated the investment account because, according to IMF officials, the Fund has not had the available excess liquidity allowing for the transfer of such resources to the investment account.

[10] Articles of Agreement, Art. V, Sec. 12(h).

- *Sales for replenishments.* On several occasions in the late 1950s and in the 1960s, the IMF sold gold to replenish its holdings of usable currencies.
- *Sales to offset operating deficits.* To generate income to offset operational deficits, the IMF sold gold to the United States and invested the proceeds in U.S. government securities. A significant buildup of reserves through income from charges to members prompted the IMF to reacquire the gold from the U.S. government in the early 1970s.
- *Gold auctions.* Between April 1976 and May 1980, the IMF disposed of 25 million fine ounces of gold to finance an IMF trust fund, which was created in 1976 to support concessional lending by the IMF to low-income countries.
- *Restitution of gold to members.* Between 1977 and 1980, the IMF restituted a total of 25 million fine ounces of gold, in four annual installments, to members in proportion to their quota shares as of August 31, 1975. For the United States, this translated into the acquisition of 5.74 million fine ounces of gold.

Appendix III

The IMF's Quota Reviews

Since the inception of the IMF in 1945, total quotas have grown substantially—from about $7 billion to about $288 billion currently. There have been 11 general reviews of quotas, as well as a special review in 1959. Of the 12 reviews, 8 have resulted in increases in total IMF quotas. IMF staff recommendations[1] for quota increases have been primarily based on formulas and have been generally significantly higher than the quota increases approved by the Board of Governors. The Executive Board has not generally relied on formulas in its decisions in prior quota reviews, but rather has primarily depended on various factors, including the IMF's liquidity and the needs of the IMF's members.

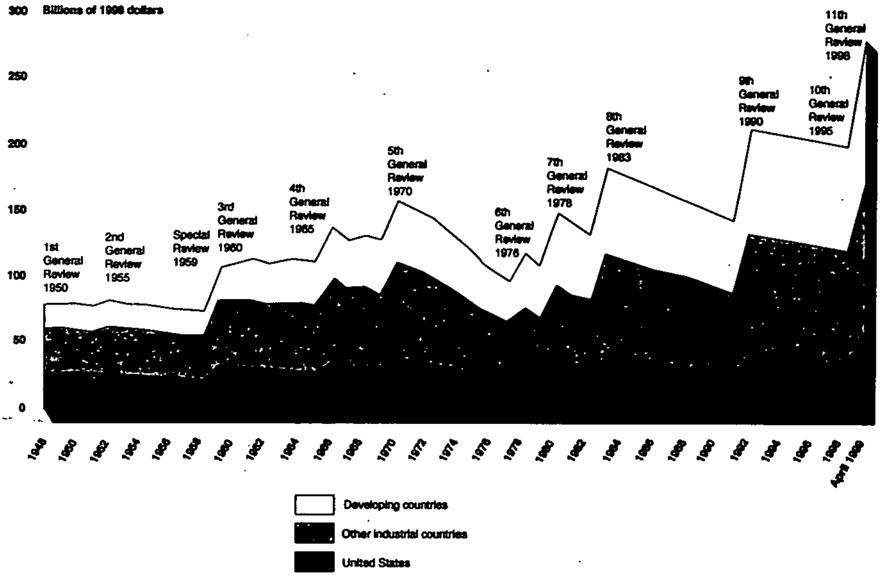
The Growth in IMF Quotas

IMF quotas have risen as a result of increased membership,[2] eight general quota increases since 1959, and several special and ad hoc increases in quotas of individual members outside of the general reviews. Figure 6 shows the growth in IMF quotas in constant 1998 dollars for the United States, other industrial countries, and developing countries over the period 1948 to April 30, 1999. During this period, the annual average real growth in quotas was about 2 percent. For the United States the annual average real growth was about 0.7 percent, compared to about 1.8 percent for other industrial countries and about 3.2 percent for developing countries. While inflation has eroded the purchasing power of quotas during certain periods, particularly in the 1970s and 1980s, quota increases have tended to restore the purchasing power of quotas. However, the quota increases under the sixth and seventh general reviews, each of which became effective 2 years after approval, did not restore the quota's purchasing power to the 1970 level.

[1]The IMF's staff recommendations included comments from IMF's Managing Director.

[2]There were 30 members of the Fund as of December 31, 1945. On March 8, 1946, the Board of Governors adopted a resolution extending the period from December 31, 1945, to December 31, 1946, in which countries could join as original members. As a result, there were 39 original members with total quotas of about $7 billion.

Figure 6: IMF Quota Resources, 1948–April 30, 1999



Note: Quota values are expressed in 1998 dollars using the average 1998 dollar SDR exchange rate and an SDR price deflator.

Source: GAO analysis of IMF data.

Comparison of Staff's Recommendations and the Board of Governors' Approved Quota Increases

From our review of IMF documents,[2] we have determined that the staff's recommendations for quota increases were generally significantly higher than the quota increases that were approved by the Board of Governors. As shown in table 4, in five reviews the staff recommended increases of as much as 100 percent, but the final approved increases ranged from zero to about 51 percent. For two reviews (the Special and Third Reviews), the Fund was not able to provide us with the staff's recommendations. In the remaining five reviews, while the staff did not always quantify the increases, its emphasis was that there should be a sizable general increase as well as selective increases to bring members' quotas more in line with their relative economic size.

The predominant factor guiding the staff's recommendations for a more enlarged IMF was the amounts derived by the quota formulas (see table 4 column 2). These formulas calculate the size of the IMF that is consistent with the growth in the world economy. However, it has been the position of executive directors that there is no single measure of the size of the world economy or indicators that are optimal for determining the size of the increase in quotas. Consequently, the results derived by the quota formulas have not had a significant bearing on the final decision on the appropriate size of the IMF.

[2]We did not review most official Committee of the Whole on Review of Quota's documents for prior quota reviews, as was done for the Eleventh General Quota Review. The majority of the information pertaining to the prior reviews was taken from the IMF's historical publications.

Table 4: General Reviews of IMF Quotas

Review/Date	Quota increase suggested from formulas	Recommended quota increase from IMF staff	Final decision by Board of Governors[a]	Percentage real growth in approved quotas[b]	Some reasons cited for increase or no increase in quotas
First Review 1950	N/A	100%	0%	-24%	N/A
Second Review 1955	N/A	Graduated scale of revision[c]	0%	-4%	Quotas were considered large and had remained relatively unused.
Special General Increase 1959	N/A	N/A	60.7%	46%	Growth in the world economy. Large amount of IMF drawings and arrangements.
Third Review 1960	N/A	N/A	0%	-1%	N/A
Fourth Review 1965	N/A	50% plus selective increases to reduce disparities in the quotas of some members.	30.7%	30%	Concerns over a possible deficiency in international liquidity. Address some members' larger positions in the world economy.
Fifth Review 1970	N/A	A general increase of reasonable size.	35.4%	11%	To better reflect some members' stronger economic positions. Reduce IMF's reliance on borrowing.
Sixth Review 1976	75%	70-100%	33.6%	-14%	Emerging high balance-of-payment deficits. Better reflect some members' stronger economic positions. Reduce IMF's reliance on borrowing.
Seventh Review 1978	90%	75-100%	50.9%	31%	Many members with small quotas reluctant to ask the Fund for assistance because of their limited access to credit. Reduce IMF's reliance on borrowing.

Continued

Review/Date	Quota increase suggested from formulas	Recommended quota increase from IMF staff	Final decision by Board of Governors[a]	Percentage real growth in approved quotas[b]	Some reasons cited for increase or no increase in quotas
Eighth Review 1983	106%	A relatively large general increase plus selective increases for many members.	47.5%	3%	Adjust members' quotas relative to their economic positions in the world economy.
Ninth Review 1990	58%	50% with a proportionate increase in IMF's borrowing authority or by about 100% if IMF's borrowing authority is not included.	50%	19%	Persistent debt problem in Latin America. Reduce IMF's reliance on borrowing.
Tenth Review 1995	34%	Selective increases based on members' shares in calculated quotas.	0%	-5%	The overall size of the IMF was considered sufficient to effectively promote its purposes.
Eleventh Review 1998	23%	100%	45%	40%	Increased demand for IMF resources. Growth in world trade and payments. Increased volatility of balance-of-payments stemming from sharp changes in private capital flows.

Continued from Previous Page

N/A = Not Available. Information was not provided by the Fund or was not available in the Fund's public documents.

Note: Table reflects reviews where some information was available on suggested increases by IMF staff.

[a]Percentage increases of Board of Governors reflect overall increases at the date the quota increase was adopted.

[b]A GAO-constructed SDR deflator is used to calculate real growth in approved quotas.

[c]Graduated scale of revision is defined as revisions diminishing with the size of the quota, with the quota increase proportionately smaller for those countries with greater quota levels.

Source: GAO analysis of IMF data.

As shown in table 4, the IMF has cited many factors as having influenced the size of the IMF's quotas in prior reviews. In certain cases, these factors justified no change in the IMF's quota size; in other cases, they justified an increase. For example, in both the second and tenth reviews, the Board decided against any increase in quotas because the IMF's resources were considered sufficient. However, in many of the other reviews, the Board recommended increases, including the need to (1) address the possible deficiency in international liquidity, (2) reduce the IMF's reliance on borrowing, and (3) adjust members' quotas to better reflect their relative position in the world economy.

Distribution of Quota Increases in Prior Reviews and Significance of Relative Shares

The large majority of quota increases in prior reviews were distributed equiproportionally, consistent with the strong desire of many countries to maintain the existing quota structure. Selective increases in member quotas change the relative size and voting shares of members within the IMF, increasing the quota share of some members while decreasing others. However, selective increases in quotas have taken place with the goal of bringing the quotas of members into better alignment with their relative economic size, and, in some cases, to strengthen the liquidity position of the IMF.

The overall quota structure between the two main groups of industrial and developing countries has been relatively stable over time. Figure 7 shows the history of voting shares.[4] As of April 30, 1999, the voting share of the industrial countries was about 60 percent, as compared with about 70 percent in 1948, and the share of the developing countries was about 40 percent, as compared with 30 percent in 1948. While the United States is still the largest contributor to the IMF's resources,[5] its voting share has fallen over time. Currently, this voting share is slightly over 17 percent, down from 31 percent in 1948.

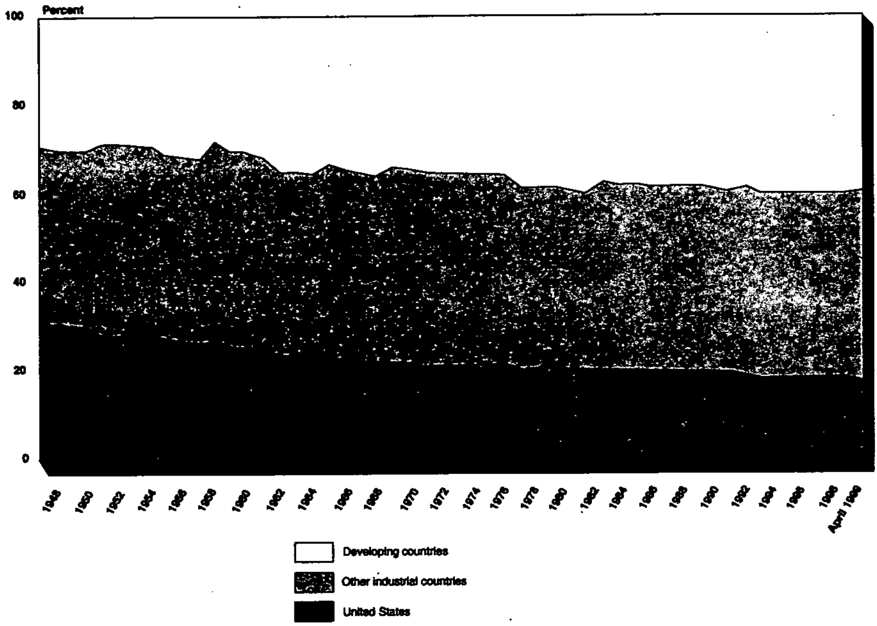
The Articles of Agreement often require 70 percent to 85 percent of the voting power of the IMF membership for approval of significant decisions. Certain decisions such as an increase in quotas or the sale of gold require an 85-percent vote of approval. Therefore, the United States can effectively veto these types of decisions based upon its voting shares. However, certain decisions, such as changing the interest rate paid by borrowers, only require a 70-percent vote of approval. The voting and quota shares of developing and transition countries have risen steadily throughout the IMF's history, increasing to 40 percent as of April 30, 1999. Thus, developing and transition countries may have sufficient voting power to

[4] In accordance with IMF's rules and regulations, the Executive Board rarely reaches decisions through formal votes, but instead works to reach a consensus among its members.

[5] The absolute size of the U.S. quota has increased from about $2.8 billion in 1945 to the current amount of about $50 billion. Other countries with large quotas include Japan and Germany (about $18 billion each) and France and the United Kingdom (about $14.5 billion each).

form a voting bloc and oppose certain decisions, such as the raising of the interest rate charged for the use of IMF resources.

Figure 7: IMF Member Voting Shares, 1948–April 30, 1999



Source: GAO analysis of IMF data.

The IMF's Lending Activities

From the IMF's first financial transaction from its GRA on March 1, 1947, through April 30, 1999, the IMF has disbursed about SDR 209 billion, or $507 billion in constant dollars.[1] These resources were disbursed through reserve tranche drawings, 710 stand-by arrangements, and 67 extended arrangements. Since 1947, the IMF's lending has involved successively larger amounts of financing and reached about $82 billion as of April 30, 1999. Additionally, the composition of industrial and developing country borrowers had changed so that by 1988, industrial countries were no longer users of IMF credit. As the IMF's lending shifted exclusively to developing countries, 15 members since 1983 have been unable to meet their obligations to the GRA when due.[2] In response to these arrears, the IMF has increased its reserves to consider potential loan losses and adopted a mechanism to share the cost of overdue obligations between debtor and creditor members. As of April 30, 1999, five members were in arrears to the GRA.

The Expansion of GRA Lending Arrangements and Facilities

Since 1947, the IMF has expanded the types of GRA lending arrangements and facilities to respond to demands by its members for increased credit and generally longer repayment terms. These lending arrangements and facilities consisted of the following nine types:

- *Stand-by arrangements*, used from 1952 to the present, are the most common form of IMF lending. Under these arrangements, members purchase currency primarily for short-term balance-of-payments assistance. Repayment terms were up to 5 years. Interest rates ranged from zero percent for the first 3 months to about 9.67 percent per year in 1985.
- *The Compensatory Financing Facility (CFF)* was available from 1963 to 1988 and was expanded in 1988 to the Compensatory and Contingency Financing Facility (CCFF). These facilities provided members experiencing shortfalls in export earnings or increased costs of cereal and oil imports with resources to purchase currency. Repayment terms were up to 5 years. Interest rates ranged from zero percent for the first 3 months to about 9.67 percent per year in 1985.

[1]The IMF's reported amounts have been adjusted to 1998 dollars using an SDR price deflator and the average 1998 dollar/SDR exchange rate.

[2]An additional two members, Iraq and Afghanistan, are also in arrears to IMF's SDR Department.

- *The Buffer Stock Financing Facility (BSFF)* was available from 1969 to 1984. The BSFF provided currency purchases for members to reduce the variability of export earnings. Repayment terms were up to 5 years. Interest rates ranged from zero percent for the first 3 months to about 9.67 percent per year in 1985. All of these loans were repaid by 1988.
- *The Oil Facility* was available for one year in 1974 and again in 1975 to finance members' purchases of oil during the 1974-75 worldwide oil crisis. The IMF borrowed funds from several industrial and oil-producing members to finance this facility. Repayment terms were up to 7 years. Interest rates ranged from about 6.88 percent to 7.88 percent per year from 1974 to 1983. All of these loans were repaid by 1983.
- *The Extended Fund Facility (EFF)*, established in 1974, provides financing to members experiencing structural balance-of-payment problems. Under these extended arrangements, repayment terms are up to 10 years. Interest rates ranged from about 4 percent to 6.88 percent per year from 1977 to 1981. In 1983, the EFF interest rate became the same as that for regular facility loans, which have ranged from about 3.42 percent per year in 1999 to about 9.67 percent per year in 1985.
- *The Supplemental Financing Facility (SFF)* was available from 1979 through 1984 to provide financing for developing country members. The IMF borrowed resources from several industrial and developing members to fund the SFF. Repayment terms were up to 7 years. The SFF was phased out after other facilities, such as the SAF and the ESAF became available. Interest rates were up to about 0.33 percent higher than regular facility loans until 1984, when the SFF interest rate became the same as that for regular facility loans. All of these loans have been repaid except for countries in arrears as of April 30, 1999.
- *The Enlarged Access to Resources (EAR)* facility was available from 1981 to 1992 to provide additional financing to developing country members. The IMF borrowed resources to fund this facility from several industrial and developing members. Repayment terms were up to 7 years. This facility was phased out after other facilities, such as the SAF and the ESAF, became available. Interest rates were up to about 0.20 percent higher than regular facility loans until 1984, when the interest rate for the EAR facility became the same as regular facility loans.

- *The Systemic Transformation Facility (STF)* was available from 1993 to 1995 to provide funding to 28 countries to transition[3] from centrally planned economies to market economies. Repayment terms were up to 10 years. Variable interest rates ranged from about 3.42 percent per year in 1999 to about 6.33 percent per year in 1993.
- *The Supplemental Reserve Facility (SRF)* was created in 1997 in response to the Asian financial crisis. The SRF provides assistance to members experiencing exceptional balance-of-payment problems that could threaten the international monetary system. Repayment terms are very short-term as amounts are due from 1- to 2-½ years. Interest rates have been about 7 percent in 1998 and 8 percent in 1999.

As the GRA lending facilities have evolved, their repayment terms have expanded from up to 5 years for stand-by arrangements, the CFF, and the BSFF; to up to 7 years for the oil and EAR facilities and the SFF; and finally, up to 10 years for extended arrangements and the STF. The recent exception is the 1- to 2-½ year repayment terms of the SRF. Of the approximately $82 billion of outstanding GRA credit as of April 30, 1999, 45 percent was under 5-year facilities, 32 percent was under 10-year facilities, 21 percent was under the 1- to 2-½ year SRF facility, and 2 percent was under 7-year facilities.

Some Members Have Been Regular Users of IMF Credit

Of the IMF's 182 member countries as of April 30, 1999, 137 members have made currency purchases and 45 members have never used IMF credit. Table 5 identifies 11 members that have been regular users of IMF credit for 20 years or more since 1947. The number of years and the period are noted for the longest and second longest periods of continuous borrowing. No industrial country has had currency purchases since 1985.

[3] The IMF considers 28 of its member countries to be countries in transition, consisting of 11 countries that comprised the former Soviet Union, 16 former Soviet bloc countries in Eastern or Central Europe, and Mongolia.

Table 5: IMF Members With 20 or More Years of IMF GRA Lending, Calendar Years 1947-98

Dollars in millions

Number	Country	Number of years of purchases	Cumulative purchases	Longest period	Second longest period
1	Philippines	30	$9,870	12 (1970-81)	7 (1983-89)
2	Pakistan	25	7,906	12 (1972-83)	8 (1991-98)
3	Argentina	24	20,928	13 (1985-97)	5 (1959-63)
4	Turkey	24	8,374	7 (1978-84)	6 (1966-71)
5	Chile	23	7,625	7 (1983-89)	7 (1963-69)
6	Haiti	23	518	7 (1961-67)	5 (1980-84)
7	Sri Lanka	23	3,053	21 (1965-84)	1 (1988)
8	Jamaica	21	3,064	15 (1981-95)	4 (1976-79)
9	Mali	21	405	9 (1964-72)	5 (1982-86)
10	Bolivia	20	916	8 (1956-63)	3 (1971-73)
11	Sudan	20	2,879	7 (1978-84)	6 (1964-69)
	Subtotal of 11 countries above	254	65,538		
	Total all borrowers	1,219	$394,159		

Note 1: Total does not include years of borrowing from the SAF/ESAF.

Note 2: Total of all borrowers includes purchases by Cuba, which is no longer an IMF member, and purchases by the former Yugoslavia that the IMF has allocated to the five successor countries, four of which have become IMF members. Serbia/Montenegro will owe the portion that the IMF has allocated to it when it becomes an IMF member.

Source: GAO analysis of IMF's *International Financial Statistics*.

The Evolution of Yields on Periodic Charges and Remuneration

A member borrowing funds from the IMF pays various charges to cover the IMF's operational expenses, including remuneration paid to the member whose currency is being borrowed. Presently, a borrower typically pays a service charge of one-half of 1 percent of the amount of each transaction at the time of disbursement, a commitment fee of one-quarter of 1 percent of an amount estimated to be drawn down annually,[4] and periodic charges for interest. Under procedures in effect since May 1, 1981, the basic periodic charge rate is determined at the beginning of each financial year. The rate

[4]The commitment fee is payable upon agreement on an arrangement, but the fee is refundable as purchases are made.

includes an amount designed to allow the IMF to meet its annual administrative expenses and net income target and to remunerate members whose currencies have been purchased by other IMF members.

On May 1, 1989, the basic periodic charge rate was modified to be based on a proportion of the SDR interest rate and changes weekly with fluctuations in the SDR interest rate.[5] For the fiscal year ended April 30, 1999, the proportion was set at 107 percent of the estimated SDR rate of 3.43 percent, or 3.67 percent. Added to this amount is a rate of 0.13 percent to cover potential loan losses under burden-sharing,[6] for a total rate[7] of 3.80 percent for all lending facilities except the SRF. When the first purchase is made under the SRF, an annual rate of charge of 300 basis points[8] above the regular rate of charge for other IMF lending is assessed on purchases, as adjusted for burden-sharing. The rate increases by 50 basis points at the end of the first year and every 6 months thereafter, until it reaches 500 basis points.

Remuneration was not paid on gold tranche deposits prior to adoption of the second amendment of the Articles on April 1, 1978. Subsequently, the IMF established an unremunerated reserve tranche for each member that was equal to 25 percent of the member's quota before the second amendment.[9] For countries that became members after April 1, 1978, an unremunerated reserve tranche position amount was fixed. This amount was based on the weighted average of the unremunerated reserve tranche to the quota of all other members on the date that the member joined the

[5]The SDR interest rate is determined by reference to a combined market interest rate, which is a weighted average of yields or rates of 3 month, short-term instruments in the capital markets of the five members whose currencies comprise the SDR.

[6]The additional charge to borrowers and lower remuneration paid to countries providing the funds is known as "burden-sharing." It was adopted by the IMF in 1986, and it is discussed further at the end of this appendix.

[7]While the yields for periodic charges and remuneration have been identified for each year, historical data was not available for calculating the weighted average of interest rates on the Fund's outstanding loan portfolio for each year since its first loan in 1947.

[8]100 basis points equal 1 percent interest.

[9]The IMF computes a remunerated reserve tranche position, which is effectively the complement of the unremunerated reserve tranche position. A detailed description of the methodology and an example is found in IMF, *Financial Organization and Operations of the IMF*, Pamphlet Series No. 45, fifth edition (Washington, D.C., IMF, 1998).

IMF. The IMF then pays interest on that part of a member's reserve tranche position in excess of the unremunerated reserve tranche position.

As quotas increase, the ratio of the unremunerated reserve tranche position to quota declines. For example, the unremunerated portion of the United States of about SDR 1.7 billion represented 25 percent of the U.S. quota subscription prior to April 1, 1978. This percentage has declined with subsequent quota increases. After the 1999 quota increase, the unremunerated portion of the United States represented about 4.5 percent of the U.S. quota. Since the IMF only pays remuneration to members on their remunerated reserve tranche position, some members have foregone significant amounts of interest income on such balances. For example, using the IMF's average remuneration rates, the United States has foregone about $2.7 billion since 1980, or almost $150 million annually on its unremunerated reserve tranche position.

The Evolution of Periodic Charges

A summary of GRA periodic charges paid by IMF members as a percentage of outstanding purchases since March 1947 follows.

- From 1947 to 1974, periodic charges were fixed at zero percent, for amounts outstanding less than 3 months, to a maximum of 5 percent for all borrowing.
- For 1975 to 1976, periodic charges ranged from a fixed amount of zero percent for amounts outstanding less than 3 months to 6 percent. Higher rates were charged by type of loan facility, to a maximum of about 7.88 percent for Oil Facility loans with a 7-year term.
- From 1977 to 1981, periodic charges were fixed from 4 percent to about 6.38 percent. Higher rates were charged by type of loan facility, to a maximum of about 7.88 percent for Oil Facility loans with a 7-year term.
- For 1982, periodic charges were fixed at 6.25 percent, and 1983 rates became variable, from about 6.60 percent to about 8.52 percent. Other rates were charged by type of loan facility, to a maximum of about 7.88 percent for Oil Facility loans with a 7-year term.
- Since August 1983, periodic charges from a low of about 3.42 percent for 1999 to a high of approximately 9.67 percent for 1985 have been determined weekly for all facilities based upon a proportion of the SDR interest rate, unadjusted for burden-sharing. Periodic charges for the SRF loans were about 7 percent in 1998 and 8 percent in 1999.

The Evolution of Remuneration

A summary of remuneration paid to members as a percentage of their remunerated reserve tranche position follows.

- From 1947 to 1969, remuneration was not paid to members.
- From 1970 to 1974, remuneration of 1.5 percent was paid.
- For 1975 and 1976, remuneration from a low of 1.5 percent to a high of about 5 percent was paid.
- From 1977 to 1981, remuneration from a low of about 3.5 percent for 1977 and 1978 to a high of about 9.79 percent for 1981 was paid quarterly, based upon 90 percent of a high SDR interest rate of about 10.88 percent.
- For 1982 and 1983, remuneration from a low of about 7.20 percent to a high of about 11.93 percent was paid quarterly, based upon 85 percent of a high SDR interest rate of about 14.03 percent.
- Since 1984, remuneration from a high of about 9.32 percent for 1990 to a low of about 3.43 percent for 1999 has been determined weekly, based upon 85 percent to 100 percent of the SDR interest rate, unadjusted for burden-sharing. The financial year 1999 average remuneration rate was set at the estimated SDR rate of 3.43 percent, less 0.15 percent to cover potential loan losses under burden-sharing, for a rate of 3.28 percent.

The Concentration of Fund Credit Has Increased Since 1983

As discussed in our letter, the share of the 10 largest users of IMF's GRA resources has steadily increased to 86 percent of total GRA credit as of April 30, 1999, the highest level since 1970. Table 6 identifies 25 members that have been among the 10 largest GRA borrowers from 1983 through 1999. Besides those remaining among the 10 largest borrowers as of April 30, 1999, 9 members have partially paid off their balances, and 6 members have fully paid off their balances. Additionally, 6 members have been among the 10 largest borrowers during this 17-year period for 9 or more years, or over half of the time.

Table 6: The 10 Largest GRA Borrowers, 1983-99

Dollars in billions

Member	Number of years among the 10 largest borrowers	10 largest balances outstanding as of April 30, 1999	Members with partially paid-off balances as of April 30, 1999	Members with fully paid-off balances as of April 30, 1999
Algeria	6	$1.8		
Argentina	17	4.9		
Brazil	11	9.5		
Chile	7			X
Czechoslovakia[a]	2		X	
Hungary	7			X
India	15		X	
Indonesia	2	9.2		
Korea	7	13.2		
Mexico	16	7.2		
Morocco	7			X
Pakistan	6		X	
Peru	5		X	
Philippines	12	1.6		
Poland	1			X
Romania	5		X	
Russia	7	17.5		
South Africa	1			X
Sudan	4		X	
Thailand	3	3.2		
Turkey	5		X	
Ukraine	4	2.7		
Venezuela	9		X	
Yugoslavia, SFR[a]	7		X	
Zambia	4			X
Total		$70.8	9	6

Note: SDR exchange rate = $1.35123 as of April 30, 1999.

[a]These member balances have accrued to successor countries.

Source: GAO analysis of IMF annual reports.

Arrears by Country Since 1983

Since 1983, there were 15 IMF members[10] that were 6 months or more in arrears to the GRA. The arrears to the GRA started with 1 member in 1983, reached a high of 11 members in 1989, 1990, and 1993, and has decreased to 5 members from 1996 through April 30, 1999. Further, the IMF has determined members in arrears to be ineligible for additional GRA lending until their arrears have been cleared. As of April 30, 1983, one member was ineligible for additional GRA lending. The number of members in arrears that were ineligible for GRA lending increased to a high of 10 members by April 30, 1990. From 1996 through April 30, 1999, the number of ineligible members decreased to four. How these arrears developed, subsequent IMF actions, and the resolution of the arrears or its status as of April 30, 1999, are discussed in the following paragraphs:

- *Cambodia* (formerly Democratic Kampuchea before 1990) is a low-income developing country that began to experience protracted arrears in May 1975. The country also was experiencing political and civil unrest, and the government was operating under the auspices of the United Nations. In December 1978, the IMF's Executive Board, in accordance with the Articles of Agreement, declared the country ineligible for additional IMF lending. As of April 30, 1993, the country had arrears to the GRA totaling about $34 million. In October 1993, Cambodia paid all of its arrears with assistance from a support group co-chaired by France and Japan, and according to the IMF, then became eligible for additional IMF credit.
- *Guyana* is a low-income developing country that began to experience protracted arrears in May 1983. In May 1985, the IMF's Executive Board declared the country ineligible for additional IMF lending. As of April 30, 1990, the country had arrears to the GRA totaling about $125 million. In June 1990, Guyana paid all of its arrears with assistance from a support group chaired by Canada, and then became eligible for additional IMF credit.
- *Vietnam* is a low-income developing country that began to experience protracted arrears in February 1984. The country also faced bilateral economic sanctions from the United States. In January 1985, the IMF's Executive Board declared the country ineligible for additional IMF lending. As of April 30, 1993, the country had arrears to the GRA totaling about $74 million. In October 1993, Vietnam paid all of its arrears with

[10] Includes remaining amounts of the former Yugoslavia pertaining to Serbia/Montenegro, which is not an IMF member.

assistance from a support group co-chaired by France and Japan and then became eligible for additional IMF lending.

- *Liberia* is a low-income developing country that began to experience protracted arrears in December 1984. In January 1986, the IMF's Executive Board declared the country ineligible for additional IMF lending. The country was also experiencing political instability and a civil war since 1989. Further actions by the IMF under its Strengthened Cooperative Strategy included issuance of a declaration of noncooperation in March 1990. As of April 30, 1999, the country had arrears to the GRA totaling about $562 million and arrears to IMF's SDR Department and Trust Fund of about $65 million. IMF's Executive Board has decided not to implement the next step of the strategy to suspend Liberia's voting rights because of the country's efforts to make regular monthly payments and to implement economic reforms.
- *Sudan* is a low-income developing country that began to experience protracted arrears in July 1984. The country has been experiencing political and internal instability and a civil war since 1983. In February 1986, the IMF's Executive Board declared the country ineligible for additional IMF lending. Further actions by IMF under its Strengthened Cooperative Strategy included issuance of a declaration of noncooperation in September 1990 and a suspension of the country's IMF voting rights in August 1993. A procedure for compulsory withdrawal of Sudan from the IMF was initiated in April 1994. However, this action has been deferred in light of Sudan's regular monthly payments and continued satisfactory implementation of a program of economic adjustments. As of April 30, 1999, the country had the largest and most protracted arrears to the GRA totaling $1.4 billion and arrears to IMF's SDR Department and Trust Fund of about $105 million. In August 1999, the IMF lifted the declaration of noncooperation and is considering reinstatement of the country's IMF voting rights.
- *Peru* is a middle-income developing country that began to experience protracted arrears in September 1985. The country was also experiencing political and internal instability. In August 1986, the IMF's Executive Board declared the country ineligible for additional IMF lending. As of April 30, 1992, the country had arrears to the GRA totaling about $853 million. In March 1993, Peru paid all of its arrears with assistance from a support group co-chaired by Japan and the United States and bridge loans from both sponsors. Peru then became eligible for additional IMF lending.
- *Zambia* is a low-income developing country that began to experience protracted arrears in April 1985 due to adverse economic conditions. In September 1987, the IMF's Executive Board declared the country

ineligible for additional IMF lending. As of April 30, 1995, the country had arrears to the GRA totaling about $1.3 billion. In December 1995, Zambia paid all of its arrears with the help of bridge loans from several IMF members and then became eligible for additional IMF lending.

- *Sierra Leone* is a low-income developing country that began to experience protracted arrears in January 1985. In April 1988, the IMF's Executive Board declared the country ineligible for additional IMF lending. The country was also experiencing political and internal instability and a civil war since 1992. As of April 30, 1993, the country had arrears to the GRA totaling about $110 million. In March 1994, Sierra Leone paid all of its arrears with assistance from an informal donor group of major industrial nations and international financial institutions, and then became eligible for additional IMF lending.
- *Somalia* is a low-income developing country that began to experience protracted arrears in July 1985. The country was also experiencing political instability, a prolonged civil war, and a virtual cessation of a functioning government. In May 1988, the IMF's Executive Board declared the country ineligible for additional IMF lending. As of April 30, 1999, the country had arrears to the GRA totaling about $250 million and arrears to IMF's SDR Department and Trust Fund of about $20 million. According to the IMF, the Executive Board has not taken any further actions as political and economic conditions in the country are so disrupted that it has not been possible for IMF staff to conduct an assessment of the country's position.
- *Honduras* is a low-income developing country that began to experience protracted arrears in November 1987 due to adverse economic conditions. In November 1989, the IMF's Executive Board declared the country ineligible for additional IMF lending. As of April 30, 1990, the country had arrears to the GRA that totaled about $29 million. In June 1990, Honduras paid all of its arrears with assistance from a consultative group chaired by the World Bank, and then became eligible for additional IMF lending.
- *Panama* is a middle-income developing country that began to experience protracted arrears in December 1987. In June 1989, the IMF's Executive Board declared the country ineligible for additional IMF lending. The country was also experiencing political and internal instability, including the December 1989 U.S. intervention in Panama (Operation Just Cause). As of April 30, 1991, the country had arrears to the GRA totaling about $243 million. In early 1992, Panama paid all of its arrears with assistance from a support group chaired by the United States and through contributions from several governments, and then became eligible for additional IMF lending.

- *Congo, Democratic Republic of* (DRC, formerly Zaire before May 17, 1997) is a low-income developing country that began to experience protracted arrears in June 1988 and again in November 1990. Arrears of about $141 million as of April 30, 1989, were cleared in 1990. However, arrears continued and in September 1991, the IMF's Executive Board declared the country ineligible for additional IMF lending. Further actions by the IMF under its Strengthened Cooperative Strategy included issuance of a declaration of noncooperation in February 1992 and a suspension of the country's IMF voting rights in June 1994. The country was also experiencing political and internal instability and a civil war since 1996. As of April 30, 1999, the country had arrears to the GRA totaling about $477 million, and its arrears to IMF's SDR Department were about $11 million. The IMF is considering initiating the procedure for compulsory withdrawal from the IMF unless the country resumes cooperation with IMF policy implementation and payments to the Fund.
- *Haiti* is a low-income developing country that began to experience various periods of protracted arrears in May 1988, November 1988, and November 1991. The country also faced international economic sanctions. As of April 30, 1994, the country had arrears to the GRA totaling about $24 million. In December 1994, a support group contributed $65 million in grants to clear Haiti's arrears to the Fund and other multilateral institutions. Haiti then became eligible for additional IMF lending.

In 1992, the Socialist Federal Republic of Yugoslavia was dissolved in the midst of conflict and the IMF allocated its Fund debts and resources to its five successor countries: Bosnia/Herzegovina, Croatia, Macedonia, Slovenia, and Serbia/Montenegro. As of April 30, 1999, the first four countries had become IMF members. In September 1992, Bosnia/Herzegovina and Serbia/Montenegro began to experience protracted arrears. Subsequently

- *Bosnia/Herzegovina* had protracted arrears to the GRA of about $31 million as of April 30, 1995. In December 1995, Bosnia/Herzegovina cleared its arrears to the Fund with the help of a bridge loan from another IMF member.
- *Serbia/Montenegro* had protracted arrears to the GRA of about $100 million, and arrears to IMF's SDR Department of about $24 million as of April 30, 1999.

Additionally, two other members were in arrears to IMF's SDR Department for amounts owed for quarterly charges on their allocation of SDRs:

- *Iraq* has not made payments to the IMF due to international economic sanctions under United Nations Security Council Resolution No. 661, adopted August 6, 1990. As of April 30, 1999, this amounted to $50 million.
- *Afghanistan* has not made payments of $5 million as of April 30, 1999.

Precautionary Balances

International and U.S. accounting standards require lending institutions to estimate a provision for loan losses that reduces the amount of outstanding lending projected to be collectable, with a corresponding amount charged to operations as an expense. The IMF is not required to follow international, U.S., or the accounting standards of any country. According to the IMF, it has never established a provision for potential loan losses because the Fund

- technically does not make a loan as members purchase currencies from the IMF with an equivalent amount of their national currency;
- determined that it could not write off any currency holdings while a country is an IMF member;
- determined that potential losses were neither probable nor estimable;
- extends lending only to members; and
- had no losses historically, even for members that have left the IMF such as Cuba.

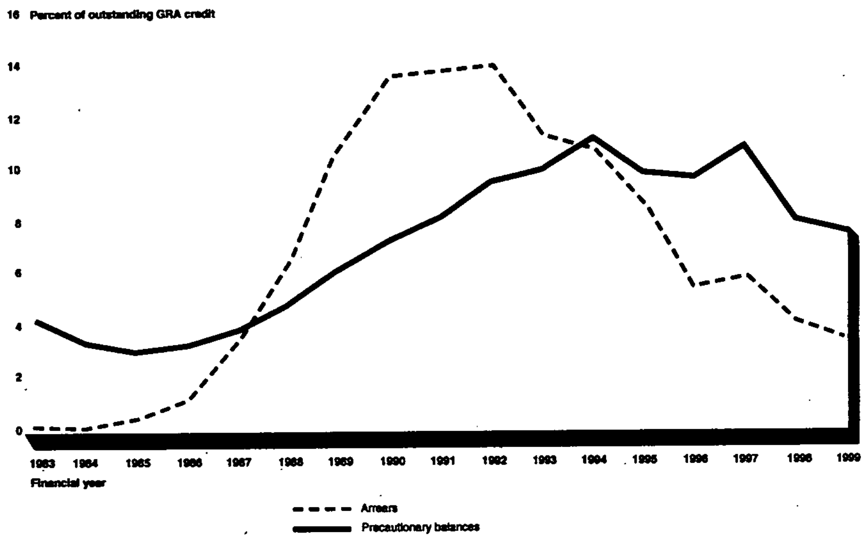
Rather than establish provisions for potential loan losses, the IMF decided to create the following accounts that it refers to as "precautionary balances," which the Fund believes can be used to absorb any potential loan losses.

- *General and Special Reserves* are provided for in the Articles of Agreement. These reserves reflect the IMF's accumulated net income. General and Special Reserves totaled approximately $1.1 billion in 1983 and increased to about $3.5 billion as of April 30, 1999. No loan losses have been charged against these reserves.
- *Special Contingent Accounts* 1 and 2 (SCA-1, SCA-2) were established in 1987, and 1990, respectively. The amount in the SCA accounts totaled about $2.7 billion as of April 30, 1999.

Precautionary Balances and Arrears

Since 1983, IMF's precautionary balances and arrears have experienced significant growth as a percentage of total GRA outstanding credit but have declined in recent years as indicated by figure 8.

Figure 8: IMF's Precautionary Balances and Arrears as a Percentage of Total GRA Outstanding Credit, 1983-99



Source: GAO analysis of IMF annual reports.

Specifically

- from 1988 through 1993, total arrears exceeded IMF's precautionary balances as a percentage of total GRA outstanding credit, until various IMF measures and financial support from certain countries reduced those amounts in arrears and

- the establishment of the SCAs contributed to the increase in total precautionary balances as a percentage of total GRA outstanding credit to absorb potential loan losses.

The Burden-sharing Mechanism

In 1986, the IMF developed a burden-sharing mechanism to share the potential cost of loan losses between borrower and creditor members. Under this mechanism, the IMF generated resources to (1) provide the Fund with interest revenue that was not paid by members in arrears to the GRA and (2) increase the balance of the two SCAs. For borrowers, the IMF increased the quarterly periodic charge for interest to include a calculated amount for the burden-sharing portion. For creditor members, the IMF calculated a reduction in the quarterly remuneration paid on such members' reserve tranche position, subject to a specific floor, for their burden-sharing portion.

Deferred Charges

Under the burden-sharing mechanism, IMF members have generated resources for deferred charges that totaled about $1 billion as of April 30, 1999. Deferred charges represent foregone interest revenue for loans 6 months or more in arrears to the IMF. When all arrears are settled, this amount can be distributed to members that received reduced remuneration or paid higher charges.

SCA-1

Since the initial placement of about $35 million in SCA-1 in 1987, the IMF has annually decided the size of SCA-1 additions before the beginning of each financial year. Under the burden-sharing mechanism, additions have amounted to 5 percent of the IMF's reserves at the start of each financial year. Balances in the SCA-1 are to be distributed to the members that shared the cost of financing when there are no outstanding overdue charges and repurchases, or at any earlier times, as the IMF may decide. As of April 30, 1999, the SCA-1 amounted to about $1.3 billion.

SCA-2

On July 1, 1990, the Executive Board established a new cooperative strategy for burden-sharing that involved accumulating resources in SCA-2. This mechanism provided the IMF with additional liquidity to finance the encashment[11] of rights following the completion of the rights accumulation program[12] by 11 eligible members. It also provided a safeguard against the risk of loss arising from currency purchases made in connection with the encashment of rights. As part of this new strategy, the IMF established a target to accumulate SDR 1 billion and further adjusted its rates of charge and remuneration whereby creditor and debtor countries contributed at a ratio of three to one. The SCA-2 account was fully funded at SDR 1 billion during 1997, for a total of about $1.4 billion as of April 30, 1999. Refunds of SCA-2 contributions are to be made after all repurchases under the rights approach have been made (or at an earlier date as the IMF may decide.)

Burden-sharing Contributions by Members

As of April 30, 1999, the IMF reported that its members' burden-sharing contributions, net of refunds, had been about $3.7 billion. The contributions have (1) strengthened the IMF's financial position by funding the foregone income it has not received from members with overdue obligations and (2) augmented its liquid resources by increasing IMF's precautionary balances. The quantitative effect of burden-sharing on IMF members is that creditor members, including the United States, have contributed about 60 percent through reduced remuneration, while debtor members have contributed about 40 percent through increased charges. The G-7, including the United States, are all creditor members. As of April 30, 1999, the G-7 had contributed a cumulative amount of about $1.5 billion, or 41 percent of the net burden-sharing contributions. The United States had contributed about $657 million, or about 18 percent of the net burden-sharing contribution, which was the largest percentage of all IMF members. Debtor members' cumulative burden-sharing contributions as of April 30, 1999, totaled about $1.5 billion, which equaled the G-7 contributions.

The levels of protracted arrears in 1989 have declined steadily since the implementation of the rights accumulation programs and the SCA-2. As of April 30, 1999, 8 of the 11 members then in protracted arrears were current with the IMF due to their participation in the rights accumulation program and financial assistance from support groups.

[11]To provide liquid resources when the members are considered eligible to receive the funds.

[12]This program allowed a member to accumulate rights to draw upon future Fund resources after clearing its arrears and is limited to the 11 members that were in protracted arrears to the Fund at the end of 1989.

Refunds of Burden-sharing Adjustments

Under the burden-sharing mechanism, it is the practice of the Executive Board to refund burden-sharing adjustments when countries in arrears settle amounts owed. These refunds have ranged from a low of zero for several quarters in the late 1980s to a high of about $370 million for the quarter ended January 31, 1996, in nominal dollars. Through April 30, 1999, the United States had received remuneration refunds of about $214 million, or about 33 percent of all remuneration refunds made by the IMF. The United States is still due a refund of about $657 million for its total burden-sharing contributions, while other IMF members are due a total of almost $3 billion.

Appendix V

The IMF's Borrowing and Credit Lines

The IMF has relied mainly on quota resources as its primary source of financing but has used borrowing and its credit lines from official sources[1] to supplement quotas when the level of its liquid resources were low. The IMF's Articles of Agreement permit borrowing from both official and private sources; however, as a matter of policy, the IMF has borrowed only from official sources. According to the IMF, this policy reflects the nature of the Fund as a cooperative, intergovernmental institution whose basic purpose is to facilitate the overall adjustment process by using some countries' surpluses to offset other countries' deficits in their balance-of-payments.

History of IMF Borrowing and Credit Lines

Borrowing has played an important role in providing temporary supplemental resources to the IMF since the early 1960s, particularly during the period of large payment imbalances that persisted from the early 1970s to the mid-1980s. Table 7 shows the relative share of borrowed resources used in financing IMF assistance to member countries from the time of its first borrowings in 1964 through April 30, 1999.

Table 7: IMF Outstanding Borrowing as a Percent of Outstanding IMF Credit 1964–April 30, 1999

1998 dollars in billions

		Outstanding IMF borrowing	
Year-end December	Amount of outstanding IMF credit	Amount	As a percent of outstanding IMF credit
1964	$10.1	$ 2.8	27.7
1965	20.6	6.3	30.6
1966	20.0	7.8	39.0
1967	15.0	4.7	31.3
1968	22.5	7.9	35.1
1969	23.3	5.6	24.0
1970	17.8	4.1	23.0
1971	7.0	0	0

Continued

[1] The official sources have included member countries and their central banks, one country that was not a member at the time the funds were borrowed (Switzerland) and its central bank, and the Bank for International Settlements.

1998 dollars in billions			
		Outstanding IMF borrowing	
Year-end December	Amount of outstanding IMF credit	Amount	As a percent of outstanding IMF credit
1972	5.4	0	0
1973	4.8	0	0
1974	15.9	7.1	44.7
1975	28.3	17.5	61.8
1976	44.1	22.9	51.9
1977	42.2	25.8	61.1
1978	30.7	19.1	62.2
1979	21.7	10.6	48.8
1980	20.9	10.4	49.8
1981	30.4	14.6	48.0
1982	41.3	17.6	42.6
1983	61.2	26.6	43.5
1984	68.6	27.7	40.4
1985	66.7	26.7	40.0
1986	61.3	24.8	40.5
1987	51.5	18.5	35.9
1988	43.1	11.5	26.7
1989	37.3	6.0	16.1
1990	33.3	5.8	17.4
1991	36.1	6.2	17.2
1992	35.8	5.2	14.5
1993	36.7	4.7	12.8
1994	36.7	4.2	11.4
1995	50.5	1.5	3.0
1996	50.2	0	0
1997	63.8	0	0
1998	82.0	5.9	7.2
April 30, 1999	81.6	0	0

Continued from Previous Page

Source: GAO analysis of IMF data.

Table 7 illustrates the continuous role of quotas in providing resources to the IMF. Borrowing and credit lines provided temporary financial support to IMF's operations during four periods.

- From 1964 to 1970, the IMF financed between approximately 23 percent and 39 percent of its outstanding GRA credit with borrowed resources from the General Arrangements to Borrow (GAB).
- From 1974 to 1986, the IMF financed between approximately 40 percent and 62 percent of its GRA credit with borrowed resources from the GAB and other agreements.
- The IMF's GRA credit financed with borrowed resources from the GAB and other agreements declined from 36 percent in 1987 to none in 1996 and 1997.
- In 1998, about 7 percent of the IMF's GRA credit was financed with borrowed resources from the GAB and the New Arrangements to Borrow (NAB). This amount was fully repaid in March 1999.

Since its inception, the Fund has entered into 11 borrowing arrangements or agreements, as shown in table 8.

Table 8: IMF Borrowing Arrangements and Agreements, 1962-98

Dollars in billions

Borrowing arrangement or agreement	Number of countries or central banks	Total amount of borrowing authority
Current borrowing arrangements:		
The GAB (1983)[a]	11	$23.0
Associated borrowing agreement with Saudi Arabia (1983)[b]	1	2.0
The NAB (1998)	25	23.0
Past borrowing agreements:		
The GAB (1962-83)[a]	10	6.4
Oil facility (1974)[c]	7	3.4
Oil facility (1975)[c]	12	3.5
Supplemental Financing Facility (SFF) (1979–84)	14	10.1
Enlarged Access to Resources (EAR):		
Medium term (1981–87)		
Saudi Arabian Monetary Agency (SAMA)	1	9.4
Short term (1981)		
Bank for International Settlement (BIS) and others	19	1.5
Short term (1984)		
SAMA, BIS, Government of Japan, and National Bank of Belgium	4	6.2
Government of Japan (1986-91)	1	3.5

[a]The GAB was revised and enlarged in 1983.

[b]Under the associated borrowing agreement, Saudi Arabia will stand ready to lend Saudi riyaals to the IMF up to an equivalent of about $2 billion. These funds are to assist the IMF in the financing of currency purchases by members for the same purposes and in the same cirumstances as are prescribed in the GAB

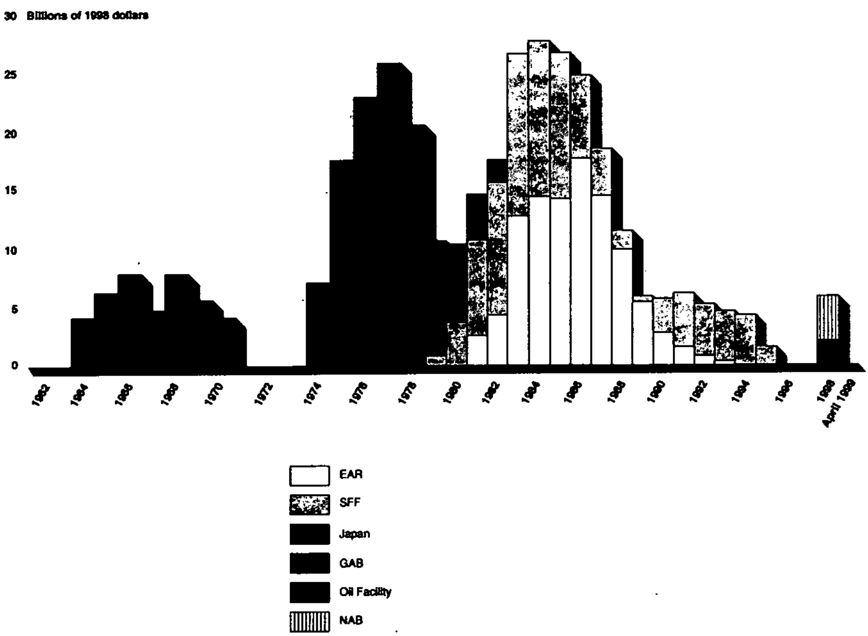
[c]The first Oil Facility was created in 1974 and was funded by seven entities. A second Oil Facility was created in 1975 and funded by 12 entities.

Source: GAO analysis of IMF data.

The IMF's 11 borrowing arrangements include 3 current credit lines from which it can borrow, with the 2 largest being the GAB, initially established in 1962, and the NAB, established in 1998. Amounts available under these credit lines have expanded from $6 billion under the GAB in 1962 to the combined total of the GAB and the NAB of about $46 billion as of April 30, 1999. Additionally, another $2 billion is available under an associate credit agreement with Saudi Arabia.

The IMF's eight past borrowing agreements were used to finance lending under the GAB in 1962 and the Oil Facility, SFF, and EAR facilities, as discussed in appendix IV. In addition, the IMF borrowed from the government of Japan under an agreement that began in 1986, with drawings terminating in 1991. Figure 9 illustrates the IMF's borrowing sources and trends since the establishment of its first borrowing arrangement in 1962 through its most recent borrowings under the GAB and the NAB in 1998.

Figure 9: Outstanding IMF Borrowing, 1962–April 30, 1999



Source: IMF's International Financial Statistics.

The GAB

The GAB was originally conceived and designed as an arrangement whereby 11 of the main industrial countries agreed to strengthen the IMF's financial position by standing ready to loan the Fund up to specified amounts of their respective national currencies. These loans could be made when the IMF needed supplemental resources to help forestall or cope with an impairment of the international monetary system.

The potential amount of credit under the GAB totaled about $6 billion (in lenders' currencies) from its inception until December 1983. In response to the growing pressure on the IMF's usable currencies caused by the Latin America debt crisis in mid-1982, the amount of credit available under the GAB was enlarged to about $23 billion, with an additional $2 billion associate credit agreement with Saudi Arabia. Table 9 shows a listing of current GAB participants and credit amounts.

Table 9: GAB Participants and Credit Amounts, as of April 30, 1999

Dollars in millions

Participant	Amount
United States	$5,743
Deutsche Bundesbank	3,216
Japan	2,871
France	2,297
United Kingdom	2,297
Italy	1,493
Swiss National Bank	1,378
Canada	1,206
Netherlands	1,149
Belgium	804
Sveriges Riksbank	517
Total	**$22,971**
Associate credit agreement with Saudi Arabia	$2,027

Note: SDR exchange rate = $1.35123 as of April 30, 1999.

Source: IMF.

At the time of the GAB's enlargement in 1983, the interest rate was raised from below market levels used in the earlier GAB, to 100 percent of the

SDR interest rate. Since its inception, the GAB has been activated 10 times, with total drawings of about $7.2 billion.

- From 1964 through 1970, the GAB was activated six times, primarily for drawings by the United Kingdom for balance-of-payments assistance. Total amounts borrowed by the IMF under the GAB activations were about $2.2 billion. All of these borrowings have been repaid.
- In 1977, the GAB was activated twice for drawings by the United Kingdom and Italy, and once in 1978 by the United States for reserve tranche purchases for balance-of-payments assistance. Total amounts borrowed by the IMF under the GAB activations were about $3 billion. All of these borrowings have been repaid.
- In July 1998, the GAB was activated for the 10th time for about $2 billion drawn as part of an extended arrangement with Russia totaling about $8.4 billion. This was the first activation of the GAB in 20 years, and the first time it has been used for a non-participant. This activation was canceled in March 1999 when the IMF repaid the $2 billion shortly after it received funds from the recent Eleventh General Review's quota increase.

The NAB

Following the Mexican financial crisis in 1994-95, IMF members were concerned that substantially more resources might be needed by the IMF to respond to future financial crises. This concern prompted the G-10 and other financially strong countries to develop financing arrangements that would double the amount available under the GAB. The NAB is a set of credit arrangements between the IMF and 25 members and institutions established in November 1998. The NAB is available to provide supplemental resources to the IMF to forestall or cope with an impairment of the international monetary system or to deal with an exceptional situation that poses a threat to the stability of that system.

Funds available under the GAB are also available under the NAB, and together they constitute a combined credit line of about $46 billion available for lending. The NAB can be activated when eligible participants representing 80 percent of the total credit arrangements determine there is a threat to the international monetary system and agree to the request. The NAB became effective in November 1998 for 5 years and may be renewed. A list of NAB participants and their credit arrangements is shown in table 10.

Table 10: NAB Participants and Credit Amounts, as of April 30, 1999

Dollars in millions

Participant	Amount
United States	$ 9,070
Deutsche Bundesbank[a]	4,807
Japan[a]	4,807
France[a]	3,482
United Kingdom[a]	3,482
Saudi Arabia[a]	2,405
Italy[a]	2,394
Swiss National Bank[a]	2,104
Canada[a]	1,887
Netherlands[a]	1,778
Belgium[a]	1,307
Sveriges Riksbank[a]	1,161
Australia	1,095
Spain	908
Austria	557
Norway	518
Denmark	501
Kuwait	466
Finland	459
Hong Kong Monetary Authority	459
Korea	459
Luxembourg	459
Malaysia	459
Singapore	459
Thailand[a]	459
Total	$45,942

[a]Also a participant in, or associated with the GAB.

Note: SDR exchange rate = $1.35123 as of April 30, 1999.

Source: IMF.

The activation requirements for the NAB are not as strict as the requirements for the GAB. Specifically, the credit arrangements under the NAB may be activated for the benefit of an IMF member that is a participant or non-participant in the NAB, under circumstances similar to those specified in the GAB. However, under the NAB, activation for a non-participant is not subject to more stringent criteria related to the IMF's liquidity situation. Nevertheless,

- the maximum combined amount drawn under the GAB and the NAB cannot exceed SDR 34 billion (about $46 billion as of April 30, 1999); and
- the NAB will be the facility of the first and principal recourse in the need to provide supplementary resources to the IMF except that (1) in the event of a request for drawing on the IMF by a participating member (or a member whose institution is a participant) in both the GAB and the NAB, a loan request may be made under either the GAB or the NAB and (2) in the event that a loan request under the NAB is not accepted, the request may be made under the GAB.

In December 1998, the NAB was first activated for about $4 billion drawn on an extended arrangement with Brazil totaling about $18.3 billion. This activation was canceled in March 1999 when the IMF repaid the $4 billion shortly after it received funds from the recent Eleventh General Review's quota increase.

Objectives, Scope, and Methodology

As required under the Omnibus Appropriations Act for fiscal year 1999, we are reporting on several matters relating to the IMF's financial operations. In this report, we reviewed the IMF's

- liquidity position as of April 30, 1999, including the Fund's experience with borrowed resources to meet its members' financing needs;
- gold holdings and its role in the IMF's financial operations; and
- process for determining the amount of quota contributions required from its members.

We also included information on how the IMF's lending activities have evolved since the Fund was founded in 1945. In addition, we discussed the status of preparedness of the IMF's mission-critical and key computer systems for the year 2000.

The scope of our work had the following limitations:

- Although we obtained the U.S. Executive Director's position papers pertaining to quota reviews, we did not have access to nonpublic statements of the other IMF executive directors, the Executive Board minutes, or information on how final quota decisions were reached by the IMF's Executive Board.
- With the agreement of Committee staff, our review of the IMF's lending did not include facilities for low-income members and administered accounts that included various trust accounts that operated from 1976 to 1986, the Structural Adjustment Facility that was established in 1986, and the Enhanced Structural Adjustment Facility that was established in 1987. Outstanding loans under these facilities amounted to about $8.8 billion as of April 30, 1999, and were discussed in a previous GAO report.[1]
- Historical data was not available for calculating the weighted average of interest rates on the Fund's lending portfolio for each year since the Fund's inception, as the Omnibus Appropriations Act requested.
- An evaluation of the IMF's efforts and related management structure and processes to address the year 2000 problem was not within the scope of our work.

[1]See *Developing Countries: Status of the Heavily Indebted Poor Countries Debt Relief Initiative* (GAO/NSIAD-98-229, Sept. 30, 1998).

Our work also included numerous interviews with IMF officials and U.S. Treasury officials and a meeting with the Fund's certified public accounting firm. Much of the information reported is as of April 30, 1999, the end of the IMF's financial year, and to the extent possible, we used data audited by the IMF's auditors. Additionally, to meet our objectives, we did the following:

- To review the IMF's liquidity position as of April 30, 1999, we reviewed the IMF's approach for calculating and reporting on its liquid resources and analyzed the reported amount of its liquid resources to determine whether adjustments the IMF made to the reported amount were practical and relevant. This included reviewing the various components that have evolved to determine the IMF's liquidity position as of April 30, 1999; the IMF's quarterly operational budgets and semiannual review papers on the Fund's liquidity and financing needs; and the IMF's methodology used in its reviews of liquidity and financing needs. In addition, we reviewed the Fund's documentation to determine if there was an analytical basis to support the liquidity ratio threshold that the IMF uses to determine when it is imprudent to lend. We also queried IMF officials about their rationale for the liquidity ratio percentage used as a minimum threshold for its lending activities.

We also analyzed the IMF's experience with borrowed resources, including its use of credit lines, to identify the amounts and periods, financing arrangements, and participants. This analysis included a ratio and trend analysis of the circumstances that led the IMF to borrow from its GAB, NAB, and other financing arrangements and agreements. In our work, we (1) reviewed the Fund's annual reports, which included its audited financial statements, books on the history of the Fund, and papers on the IMF's financing needs and (2) analyzed the IMF's data base of *International Financial Statistics* on outstanding borrowing.

- To review the IMF's gold holdings and its role in IMF's financial operations, we reviewed the history of IMF's acquisition and use of gold from 1946 to the present period, and conducted a detailed review of the Fund's governing principles and explanations for holding gold. We compared the Fund's policies to evolving gold management practices by several other official holders of gold and analyzed gold acquisition and use data over the history of the Fund's operations. We reviewed historical accounts and related IMF documentation that described the evolution of gold management practices. We also reviewed published reports on alternative uses for gold and the evolving nature of gold management practices. Finally, we discussed all of these issues with

Fund staff from the Treasurer's office and gold experts from the U.S. Treasury, two U.S. mining companies, the World Gold Council, and the Gold Institute.

- To review the IMF's process for determining quota contributions from members, we obtained and reviewed the Fund's policies and procedures supporting its quota increase from the Eleventh General Review in 1999. We also reviewed information on the quota review and more general information on 11 other quota reviews since 1950. In our review, we gained an understanding of the quantitative and qualitative factors the IMF takes into consideration to determine a quota increase. These factors included (1) if and when a quota increase is needed, (2) the size of a quota increase, (3) how the quota increase was distributed among member countries, and (4) what formulas were used to calculate members' quotas. In doing so, we reviewed the U.S. Executive Director's position papers pertaining to quota reviews. We also reviewed the IMF's (1) documents on the official Committee of the Whole on Review of Quotas for the Eleventh General Review, (2) semiannual review papers on liquidity and financing needs, (3) annual reports, (4) the IMF pamphlet, *Financial Organization and Operations of the IMF*, and (5) historical publications. In addition, we queried IMF officials and the U.S. Executive Director to obtain their comments on the IMF's quota review process.
- To review the evolution of the IMF's GRA lending activities since the first transaction in 1947, we identified the types and terms of lending facilities, regular users of IMF credit, and the 10 largest users of IMF credit. We also reviewed the evolution of yields on periodic charges and interest remuneration, members in arrears, the funding of precautionary balances, and the effect of the burden-sharing mechanism on the Fund's financial operations and on its members. To conduct our review, we analyzed the IMF's (1) data base of *International Financial Statistics*; (2) annual reports from 1947, which included audited financial statements; (3) key publications, including its *Articles of Agreement of the International Monetary Fund* and *Financial Organization and Operations of the IMF*; (4) various policy documents and staff position papers; and (5) data on financial transactions for member countries. We also discussed the Fund's lending activities with IMF officials, the U.S. Executive Director, and the Fund's certified public accounting firm to gain an understanding of the GRA lending activities.
- To review the status of preparedness of the IMF's mission-critical computer systems for the year 2000, we reviewed information from IMF's web site and held discussions with Fund officials and the IMF's certified public accounting firm. We met with IMF's Management

Information Systems specialists and discussed the Fund's status for testing its mission-critical computer systems and developing and testing its contingency plans. We also queried other IMF officials about the status of its members' year 2000 readiness and the potential impact on the IMF's operations if the members were not compliant. Additionally, we met with the Fund's certified public accountants for their assessment of the IMF's year 2000 readiness.

We conducted our review between December 1998 and August 1999 in accordance with generally accepted government auditing standards.

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