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# *THE EXCHANGE STABILIZATION FUND OF THE U.S. TREASURY DEPARTMENT: PURPOSE, HISTORY, AND LEGISLATIVE ACTIVITY*


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Updated September 20, 1999


**Abstract.** In 1997 and 1998, as part of international support packages, the United States agreed to provide contingent financing from the U.S. Treasury Department's Exchange Stabilization Fund of $5 billion for Brazil, $3 billion for Indonesia and $5 billion for South Korea. This report provides a history of the ESF (which was established in 1934) as well as the statutory authority (31 U.S.C. 5302) cited by the Treasury Department for making loans to foreign governments from the ESF. To provide perspective, the amounts, loan and repayment dates of all ESF loans to foreign governments since 1980 are given. Recent legislative actions to limit the amount of ESF loans are summarized.

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# The Exchange Stabilization Fund of the U.S. Treasury Department: Purpose, History, and Legislative Activity

Updated September 20, 1999

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## ABSTRACT

In late 1998, as part of an international support package, the United States agreed to provide contingent financing from the U.S. Treasury Department's Exchange Stabilization Fund of $5 billion for Brazil. This report provides a brief history of the ESF (which was established in 1934) as well as the statutory authority (31 U.S.C. 5302) cited by the Treasury Department for making loans to foreign governments from the ESF. To provide perspective, the amounts, loan and repayment dates of all ESF loans to foreign governments since 1980 are given. Recent legislative actions to limit the amount of ESF loans are summarized. This product, which supercedes CRS Report 98-583 E, will be updated when legislative activity occurs or ESF funds are committed or disbursed to foreign governments.

# The Exchange Stabilization Fund of the U.S. Treasury Department: Purpose, History, and Legislative Activity


## Summary

As part of an international support package, the United States agreed, in November 1998, to provide contingent financing of $5 billion to Brazil. Funds would come from the Department of the Treasury's Exchange Stabilization Fund (ESF).

Some congressional concern has been expressed about the ESF's ability to make foreign loans without congressional approval. Appropriation legislation in the 104th Congress imposed limitations on the use of the ESF (P.L. 104-52, Section 632 and P.L. 104-208, Section 628), but the limitations expired at the end of fiscal year 1997. Seven bills were introduced in the 105th Congress which would have imposed restrictions on the amount of ESF loans, but did not receive floor action. Amendment No. 16 (to H.R. 4104) restricting the amount of ESF loans was defeated in a House vote on July 16, 1998. In the 106th Congress, H.R. 1540 (ESF Transparency and Accountability Act), which would impose limitations on ESF loans, was introduced on April 22, 1999, but has not received floor action.

The Exchange Stabilization Fund was established by Section 20 of the Gold Reserve Act of January 30, 1934 (48 Stat. 337, 341) to stabilize the exchange value of the dollar. At that time, the ESF received an appropriation of $2 billion from the revaluation of U.S. gold holdings. Since then, no money has been appropriated; its income has come largely from interest on investments and loans, as well as net gains made in transactions in the foreign exchange market. As of late September 1999, the ESF had about $30 billion available to lend.

The ESF engages in monetary transactions in which one asset is exchanged for another, such as foreign currencies for dollars. It is under the control of the Secretary of the Treasury, subject to approval of the President. The Treasury Department cites 31 U.S.C. Section 5302 as its statutory authority for providing financing to other countries through the Exchange Stabilization Fund.

One use of the ESF has been to provide resources for intervention in the foreign exchange market. The ESF also has been used to finance short-term loans to both developed and developing countries and, since 1980, has provided loans to 18 countries. From 1980 to 1994, Mexico, Brazil and Argentina were by far the largest borrowers. Since 1995, Mexico has been the only recipient of ESF loans. After the 1994 Mexican peso crisis, ESF loans to Mexico totaled $12 billion, which were repaid by January 1997.

The argument in favor of restricting the use of the ESF is that the Congress should have a voice in how billions of dollars are spent. The argument against restrictions is that the ESF provides the Treasury Department with a much-needed quick and flexible tool to respond to international financial crises.


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# The Exchange Stabilization Fund of the U.S. Treasury Department: Purpose, History, and Legislative Activity

As part of an international support package, the United States agreed, in November 1998, to provide contingent financing of $5 billion to Brazil.[1] Funds would come from the Department of the Treasury's Exchange Stabilization Fund (ESF). As of late September 1999, no funds have been drawn from the ESF under this agreement.

Some congressional concern has been expressed about the ESF's ability to make foreign loans without congressional approval. Appropriation legislation in the 104th Congress imposed limitations on the use of the ESF (P.L. 104-52 and P.L. 104-208), but the limitations expired at the end of fiscal year 1997. Several bills were introduced in the 105th Congress to reimpose restrictions, but none received floor action. An amendment to H.R. 4104 to reimpose restrictions was defeated in a House vote on July 16, 1998. In the 106th Congress, H.R. 1540, which would impose restrictions, was introduced April 22, 1999, but no floor action has occurred.

The ESF engages in monetary transactions in which one asset is exchanged for another, such as foreign currencies for dollars. It is under the control of the Secretary of the Treasury, subject to approval of the President. The Fund provides flexibility to respond quickly to unexpected stresses in international financial markets. The Treasury Department cites 31 U.S.C. Section 5302 (see box on p. 3) as its statutory authority for providing financing to other countries through the Exchange Stabilization Fund.

The purpose of this report is to provide an overview of the past and current roles of the Exchange Stabilization Fund, the loans provided by the ESF to foreign countries since 1980, and bills introduced in recent years to limit the ESF.

## Brief History

The ESF was established by Section 20 of the Gold Reserve Act of January 30, 1934 (48 Stat. 337, 341) to stabilize the exchange value of the dollar. At that time, similar funds of European countries were having a significant effect on exchange markets. The purpose of the ESF was to give the United States adequate financial

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[1]A discussion of the global financial crisis is beyond the scope of this report. See CRS Report RL30012, *Global Financial Turmoil: Contagion, Effects, and Policy Responses*, by Dick K. Nanto.

resources to counteract the activities of the European funds.[2] It was established with $2 billion appropriated from profits realized from the revaluation of U.S. gold holdings. The Gold Reserve Act provided temporary authority for the ESF, which was renewed periodically until it was made permanent in 1945.

The ESF was used actively in the 1930s to manage the dollar's exchange rate. After World War II, when the International Monetary Fund (IMF) was established, the ESF was the source of funds for the U.S. contribution. As provided in the Bretton Woods Agreement Act of 1945 (59 Stat. 514), $1.8 billion of the ESF's capital of $2 billion was used to make a partial payment on the U.S. subscription to the IMF.[3] The Bretton Woods Agreement Act of 1945 also included permanent authority for the ESF.

During the 1960s, the likelihood that the United States would have to withdraw foreign currencies from the IMF to support the dollar increased. The ESF was authorized to receive foreign currencies which the United States withdrew from the IMF. In 1968, when the IMF first issued special drawing rights (SDRs), the ESF was authorized to receive the SDRs allocated to the United States.

The statutory language reflecting the purpose of the ESF was changed somewhat in 1976 and 1977. After fixed exchange rates were replaced by a floating exchange rate system in 1973,[4] the IMF Articles of Agreement were amended to conform to the current international monetary system. In the Second Amendment to the Articles of Agreement of the IMF, which became effective in 1978, countries were no longer required to maintain fixed par values for their currencies. To conform to the Second Amendment, the language alluding to "stabilizing the exchange value of the dollar" was deleted and language referring to "being consistent with U.S. obligations in the IMF regarding orderly exchange arrangements and a stable system of exchange rates" was inserted.

One use of the ESF has been to provide resources for intervention in the foreign exchange market. Since 1962, the Federal Reserve System has also taken an active role in foreign exchange intervention, and has swap (reciprocal currency) arrangements with Canada and Mexico totaling $5 billion as of March 31, 1999.[5] Generally, U.S. Treasury loans to foreign countries are made under special swap arrangements negotiated when necessary, while the Federal Reserve has continuing

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[2]U.S. Congress. House. Committee on the Budget. *Exchange Stabilization Fund.* Hearing before the Task Force on Tax Expenditures and Off-Budget Agencies, 94th Cong., 2nd sess., February 18, 1976, p. 3.

[3]Under current law, U.S. participation in an IMF quota increase must be approved by the U.S. Congress (22 U.S.C. 286c).

[4]In a fixed exchange rate system, a government agrees to maintain its currency at a specified rate, while in a floating exchange rate system, supply and demand in the market determine the exchange rate.

[5]Treasury and Federal Reserve Foreign Exchange Operations. *Federal Reserve Bulletin*. June 1999, p. 400.

swap arrangements.[6] As of March 31, 1999, the U.S. Treasury had ESF swap arrangements in effect of $3 billion with the Bank of Mexico.

**31 U.S.C. 5302 Stabilizing exchange rates and arrangements**

(a)(1) The Department of the Treasury has a stabilization fund. The fund is available to carry out this section, section 18 of the Bretton Woods Agreement Act (22 U.S.C. 286e-3), and section 3 of the Special Drawing Rights Act (22 U.S.C. 286o), and for investing in obligations of the United States Government those amounts in the fund the Secretary of the Treasury, with the approval of the President, decides are not required at the time to carry out this section. Proceeds of sales and investments, earnings, and interest shall be paid into the fund and are available to carry out this section. However, the fund is not available to pay administrative expenses.

(2) Subject to approval by the President, the fund is under the exclusive control of the Secretary, and may not be used in a way that direct control and custody pass from the President and the Secretary. Decisions of the Secretary are final and may not be reviewed by another officer or employee of the Government.

(b) Consistent with the obligations of the Government in the International Monetary Fund on orderly exchange arrangements and a stable system of exchange rates, the Secretary or an agency designated by the Secretary, with the approval of the President, may deal in gold, foreign exchange, and other instruments of credit and securities the Secretary considers necessary. However, a loan or credit to a foreign entity or government of a foreign country may be made for more than 6 months in any 12-month period only if the President gives Congress a written statement that unique or emergency circumstances require the loan or credit be for more than 6 months.

(c)(1) By the 30th day after the end of each month, the Secretary shall give the Committee on Banking, Finance and Urban Affairs of the House of Representatives and the Committee on Banking, Housing and Urban Affairs of the Senate a detailed financial statement on the stabilization fund showing all agreements made or renewed, all transactions occurring during the month, and all projected liabilities.

(2) The Secretary shall report each year to the President and the Congress on the operation of the fund.

(d) A repayment of any part of the first subscription payment of the Government to the International Monetary Fund, previously paid from the stabilization fund, shall be deposited in the Treasury as a miscellaneous receipt.

The ESF has also been used to finance short-term loans with both developed and developing countries. The short-term nature of the financing has been emphasized by an amendment to the ESF statute requiring the President to notify the Congress if a

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[6]Swap arrangements are short-term reciprocal currency agreements between major foreign central banks and the U.S. Federal Reserve and the U.S. Department of the Treasury. In effect, they are lines of credit, up to an agreed upon amount, that either country can draw on it if needs foreign currencies to intervene in the foreign exchange market, or to make short-term loans to foreign governments that are experiencing balance of payments problems. See also CRS Report 95-169 E, *The Mexican Peso Devaluation and Swap Arrangements,* by Arlene Wilson.

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loan or a credit to a foreign country is made for more than 6 months in any 12-month period. Most of the ESF swap arrangements were part of a multilateral financing package, usually in anticipation of, or in support of, an IMF stabilization program, or together with loans by foreign central banks through the Bank for International Settlements (BIS).

## Income and Resources of the ESF

No funds have been appropriated to the ESF since the initial $2 billion appropriation in 1934. One source of the ESF's income is interest on its investments or loans. The Exchange Stabilization Fund invests part of its funds in U.S. and foreign securities which pay market interest rates and have a high degree of liquidity and credit quality. It also receives interest and some fees from loans to foreign countries. Second, the ESF has both gains and losses from its operations in foreign exchange markets (except in swap agreements which have no exchange risk). On balance, over the years, gains have exceeded losses, providing a substantial amount of income. As of late September 1999, resources available for lending are approximately $30 billion.

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## ESF Financing from 1980 through March 1999

**Table 1** on pages 5 and 6 provides information on the drawings and repayments under Exchange Stabilization Fund swap agreements between 1980 and 1999. It is important to note that the table reflects *only ESF* financing agreements; financing was also provided through Federal Reserve swap arrangements over this period.

As shown in **Table 1**, Mexico, Brazil and Argentina were by far the largest borrowers from 1980 to 1994. In this period, drawings from the ESF totaled $3.0 billion for Mexico, $2.1 billion for Brazil, and $1.7 billion for Argentina. Importantly, all drawings were repaid. Except for a $600-million swap agreement with Mexico in 1982, all drawings were repaid within 6 months. In fact, some were of much shorter duration. Two drawings (Costa Rica and Peru) were repaid the same day. Eleven other drawings were paid back within one month. Sixteen more were repaid within 3 months.

**Table 1. Exchange Stabilization Fund Financing Agreements, 1980-99**

| Country | Year | Amount Agreed ($mil.) | Drew Amount ($mil.) | Drew Date(s) | Repaid in Full by |
|---|---|---|---|---|---|
| Mexico | 1982 | 1,000.0 | 825.0 | 8/14/82 | 8/24/82 |
| Mexico | 1982 | 600.0 | 600.0 | 9/82-2/83 | 8/23/83 |
| Mexico | 1986 | 273.0 | 273.0 | 8/86-12/86 | 2/13/87 |
| Mexico | 1988 | 300.0 | 300.0 | 8/1/88 | 9/15/88 |
| Mexico | 1989 | 425.0 | 384.1 | 9/25/89 | 2/15/90 |
| Mexico | 1990 | 600.0 | 600.0 | 3/28/90 | 7/90 |
| Mexico | 1995 | 20,000.0 | 250.0 | 11/11/95 | 3/14/95 |
| Mexico | | | 250.0 | 1/13/95 | 3/14/95 |
| Mexico | | | 1,000.0* | 2/2/95 | 1/29/96 |
| Mexico | | | 3,000.0# | 3/14/95 | 1/16/97 |
| Mexico | | | 3,000.0# | 4/19/95 | 8/5/96 |
| Mexico | | | 2,000.0# | 5/19/95 | 8/5/96 |
| Mexico | | | 2,500.0# | 7/5/95 | 1/16/97 |
| Brazil | 1982 | 500.0 | 500.0 | 10/82-11/82 | 12/28/82 |
| Brazil | 1982 | 280.0 | 280.0 | 11/82 | 2/1/83 |
| Brazil | 1982 | 450.0 | 450.0 | 11/82 | 3/3/83 |
| Brazil | 1982 | 250.0 | 250.0 | 12/82 | 1/83 |
| Brazil | 1983 | 200.0 | 200.0 | 2/28/83 | 3/11/83 |
| Brazil | 1983 | 200.0 | 200.0 | 3/3/83 | 3/11/83 |
| Brazil | 1988 | 250.0 | 232.5 | 7/29/88 | 8/26/88 |
| Argentina | 1984 | 300.0 | 0.0 | | |
| Argentina | 1984 | 500.0 | 500.0 | 12/28/84 | 1/15/85 |
| Argentina | 1985 | 150.0 | 143.0 | 6/85 | 9/30/85 |
| Argentina | 1987 | 225.0 | 225.0 | 3/9/87 | 7/15/87 |
| Argentina | 1987 | 200.0 | 190.0 | 11/12/87 | 12/30/87 |
| Argentina | 1988 | 550.0 | 550.0 | 2/88-3/88 | 5/31/88 |
| Argentina | 1988 | 265.0 | 79.5 | 11/22/88 | 2/28/89 |

**Table 1. Exchange Stabilization Fund Financing Agreements, 1980-99 (Continued)**

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| Country | Year | Amount Agreed ($mil.) | Drew Amount ($mil.) | Drew Date(s) | Repaid in Full by |
|---|---|---|---|---|---|
| Jamaica | 1984 | 50.0 | 10.0 | 12/29/84 | 3/2/85 |
| Philippines | 1984 | 45.0 | 45.0 | 11/7/84 | 12/28/84 |
| Ecuador | 1986 | 150.0 | 75.0 | 5/16/86 | 8/14/86 |
| Ecuador | 1987 | 31.0 | 31.0 | 12/4/87 | 1/26/88 |
| Nigeria | 1986 | 37.0 | 22.2 | 10/31/86 | 12/10/86 |
| Yugoslavia | 1988 | 50.0 | 50.0 | 6/15/88 | 9/30/88 |
| Venezuela | 1989 | 450.0 | 450.0 | 3/15/89 | 4/3/89 |
| Venezuela | 1990 | 104.0 | 25.0 | 3/30/90 | 4/30/89 |
| Bolivia | 1986 | 100.0 | 0.0 | | |
| Bolivia | 1989 | 100.0 | 100.0 | 7/89 | 9/15/89 |
| Bolivia | 1989 | 100.0 | 75.0 | 9/22/89 | 12/29/89 |
| Bolivia | 1989 | 75.0 | 75.0 | 12/29/89 | 1/2/90 |
| Poland | 1989 | 200.0 | 86.0 | 12/28/89 | 2/9/90 |
| Guyana | 1990 | 31.8 | 31.8 | 6/20/90 | 9/90 |
| Honduras | 1990 | 82.3 | 82.3 | 6/28/90 | 11/20/90 |
| Hungary | 1990 | 20.0 | 20.0 | 6/90-7/90 | 9/5/90 |
| Costa Rica | 1990 | 27.5 | 27.5 | 5/21/90 | 5/21/90 |
| Romania | 1991 | 40.0 | 40.0 | 3/7/91 | 3/21/91 |
| Panama | 1992 | 143.0 | 143.0 | 1/31/92 | 3/92 |
| Peru | 1993 | 470.0 | 470.0 | 3/18/93 | 3/18/93 |

Source: Abstracted by CRS from quarterly articles entitled "Treasury and Federal Reserve Foreign Exchange Operations" in the *Federal Reserve Bulletin*.

Note: In the drawings and repayments columns, monthly data were used in some cases in the absence of specific dates or because more than one drawing was made under one swap agreement. In the case of Mexico, each of the seven drawings under the 1995 $20,000 million swap agreement is listed separately because of their large size.

* A 90-day loan which was rolled over three times.
\# A medium-term (2 to 5 year) loan.

Since 1995, Mexico has been the only recipient of ESF loans. The 1994 Mexican peso crisis resulted in a $38 billion international support package, of which the United States agreed to contribute $20 billion, mostly through the ESF. The $20 billion, large in relation to previous ESF swap agreements, also included medium-term

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loans and loan guarantees. Although loan guarantees are relatively rare, there are several precedents. The ESF guaranteed a BIS loan of $500 million to Brazil in 1982 and a BIS loan to Yugoslavia for $75 million in 1983, and provided a guarantee for an unspecified amount for Macedonia in early 1994.[7]

As it turned out, ESF loans to Mexico totaled $12 billion, all of which were made in 1995. Of the $12 billion, $10.5 billion were in medium-term (2 to 5 year) loans. One of the short-term (90 day) loans was renewed three times. All of the loans were repaid in a timely way; the medium-term loans were repaid ahead of schedule. All loans were repaid by January 16, 1997. Loan guarantees were not used.

# Legislative Activity

## 104th Congress

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In the fiscal years ending September 30, 1996 and 1997, appropriation legislation included some limitations on the size and duration of ESF loans that could be made without congressional approval. The provisions of P.L. 104-52, Section 632, which applied to fiscal year 1996, were the same as those of P.L. 104-208, Section 628 for fiscal year 1997.

The main provisions of both laws were as follows:

- An ESF loan of more than 60 days to a foreign country required the President to certify to the appropriate congressional committees that there was no projected cost to the United States and that the U.S. expenditure was adequately backed by an assured source of repayment.

- An ESF loan to a foreign government greater than $1 billion for more than 180 days required an Act of Congress, with a waiver if the President certified in writing to the Congress that a financial crisis in a foreign country was a threat to U.S. interests or to the international financial system. If the Congress, within 30 days, enacted a joint resolution of disapproval, the certification would not take effect. To become effective, such a joint resolution requires the signature of the President or a veto override. Expedited procedures for such a joint resolution were detailed in both laws.

- ESF loans to Mexico under the assistance package announced by the President on January 31, 1995 were specifically exempted from the provisions of both laws.

## 105th Congress

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[7]Treasury and Federal Reserve Foreign Exchange Operations. *Federal Reserve Bulletin*, March 1983, p. 144, and June 1983, p. 407, and Statement by the U.S. Department of the Treasury, February 1, 1995.

Since the expiration of P.L. 104-208 on September 30, 1997, there have been no congressionally-mandated restrictions in effect on ESF loans. Seven bills were introduced in the 105th Congress that would impose restrictions on the amount of ESF loans under certain conditions, require money to be transferred from the ESF to another fund, or require reports by the Administration on the ESF.[8] None of these bills received floor action.

On July 16, 1998, House Amendment No. 16 to H.R. 4104 (The Treasury-Postal Operations Appropriations Bill) was introduced. The text of the Amendment was:

> At the end of the bill, insert after the last section (preceding the short title) the following new section:
>
> SEC. 648. None of the funds made available in this Act may be used to make any loan or credit in excess of $250,000,000 to a foreign entity or government of a foreign country through the exchange stabilization fund under section 5302 of title 31, United States Code.

After a floor discussion[9] House Amendment No. 16 failed by a recorded vote of 195-226.

## 106th Congress

On April 22, 1999, H.R. 1540 (ESF Transparency and Accountability Act) was introduced. It requires the Secretary of the Treasury to provide specified congressional committees with a detailed financial statement on the Exchange Stabilization Fund and to make the Fund's Annual Report to the President and the Congress available to the public. H.R. 1540 also prohibits the Secretary of the Treasury from making any expenditure or loan or more than $1 billion from the Fund without Congressional approval unless the President certifies that it is necessary to address a financial crisis. As of September 20, 1999, H.R. 1540 has not received floor action.

# Pros and Cons of Limiting the ESF

The argument in favor of restricting the use of the ESF is that the Congress, and ultimately the taxpayer, should have a voice in whether and how billions of dollars are spent. Since appropriations are not required for the ESF, the Congress does not, under current law, have an opportunity to debate or vote on potential loans to foreign governments. It is argued that since the Congress openly debates authorizations and appropriations of far smaller amounts, Congress should have the chance to do so when ESF funds to foreign governments are committed.

The argument against imposing restrictions is that the ESF provides the U.S. Treasury Department with a rapid and flexible tool to respond to international financial crises. In recent years, technological change and large increases in

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[8]H.R. 3106, H.R. 3138, H.R. 3573, H.R. 3114, H.R. 3580, S. 1458, and S. 1962.

[9]See *Congressional Record*, July 16, 1998, p. H5698-5719.

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international capital flows mean that crises can spread more rapidly. The Treasury contends that the availability of the ESF could play a crucial role in stemming potential crises. There is no evidence to suggest that the ESF has abused its authority. Previous ESF loans to foreign governments were all repaid in a timely way.

A recent study, which examined the history, legal bases, and financial operations of the ESF, focused on the basic question: "How can the United States maintain democratic accountability for executive branch officials engaged in international financial rescues and at the same time preserve a capacity to respond to financial crises with speed, flexibility, and effectiveness?[10] The study concluded that, since financial markets are imperfect, the United States should maintain the Exchange Stabilization Fund under the sole authority of the Department of the Treasury. However, the study also concluded that the Secretary of the Treasury should continue to manage the ESF conservatively and should increase the transparency of the ESF, while the Congress should maintain oversight over the Secretary's administration of the ESF.

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[10]C. Randall Henning. *The Exchange Stabilization Fund: Slush Money or War Chest?* Institute for International Economics, Washington, D.C. May 1999, p. 2-3.