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THE TRANSPARENCY AND FINANCIAL STRUCTURE OF THE IMF

HEARING

before the

JOINT ECONOMIC COMMITTEE CONGRESS OF THE UNITED STATES

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Thursday, July 23, 1998

HOUSE OF REPRESENTATIVES,
JOINT ECONOMIC COMMITTEE,
WASHINGTON*, *D.C.

The Committee met, pursuant to notice, at 10:00 a.m., in Room 2220, Rayburn House Office Building, the Honorable Jim Saxton, Chairman of the Committee, presiding.

Present: Representatives Saxton, Sanford, Doolittle, Ewing, Stark and Hinchey; Senator Bingaman.

Staff Present: Christopher Frenze, Colleen J. Healy, Robert Keleher, Howard Rosen, Dan Lara, Daniel Guido, Joe Cwiklinski, Amy Pardo, and Tami Ohler.

OPENING STATEMENT OF REPRESENTATIVE JIM SAXTON, CHAIRMAN

Representative Saxton. Good morning, everyone. Welcome aboard. I am very pleased to welcome Mr. Johnson and his colleagues from the General Accounting Office, the GAO, here before the Committee this morning. I would like to thank the GAO team of economists and accountants that has reviewed the finances of the International Monetary Fund (IMF) for the last several months.

Since last fall, along with a number of others here in Congress, I have been pushing for IMF openness, which we, of course, refer to as transparency. While this has resulted in some additional information being released, Congress has still not been provided with an adequate explanation of IMF finances and operations.

The time has come for Congress to take action on its own and use the means at our disposal to provide increased transparency at the IMF. As a result of this hearing this morning, more factual information about the finances of the IMF will be in the public domain than ever before. This will enable all of us to take a fresh look at the IMF and examine the financial issues with an open mind, regardless of what position we may have taken in the past. While reasonable people may disagree over various issues related to the IMF, its role, its history, et cetera, there will be now a better understanding of IMF finances on all sides.

Three main issues to be discussed today appear to be among the most important: First, the amount of resources the IMF has access to: that is, the quota that we are being asked to increase the GAB, the General Arrangements to Borrow, the new agreements to borrow; as well as other sources of income which will be discussed today, in particular, issuing of bonds; second, the degree to which the International Monetary Fund can address its own liquidity needs, without the interference or the involvement of Congress; and, finally, an issue which is somewhat arcane but very important, the problem that arises when the International Monetary Fund lends long term, as it is today, which is relatively new historically, but borrows over the short term. In other words, long-term obligations propped up by short-term borrowing.

First, the facts presented today show that the alleged impoverishment of the IMF is more than a bit exaggerated. The report will show that the IMF holds about $43 billion in usable quotas, that is, monies that are contributed by various countries. Thirty-two billion dollars in gold are also an IMF asset. And the IMF can borrow up to $23 billion under the General Arrangements to Borrow. Thus the IMF holds or has access to about $98 billion, a tidy sum even if not all of it can be loaned.

Moreover, the IMF can borrow huge sums from private financial markets; $60 billion would be well in keeping with the historic guidelines. Even if the Russian loan is fully disbursed in compliance with loan conditions, the IMF would have a kitty of about $80 billion, not counting private sector borrowing. This is a far cry from the impoverishment which has been alleged.

Second, the IMF is not helpless to address its own liquidity problems. As noted, the IMF can sell bonds to raise money and provide usable resources for operations. The IMF's liquidity ratio, which we will hear about today, can be used to portray an impoverished IMF. But this argument is often presented without mentioning the fact that the IMF can raise funds not even counted in the ratio by issuing bonds. Moreover, the changing financial structure of the IMF over time makes the validity of historical comparisons of the liquidity ratio very dubious unless these structural changes are taken into account.

Three, the IMF has evolved from an institution with liquid assets and liabilities to one in which assets have become longer term, but liabilities are still, or borrowing is still, very short term. This mismatch of assets and liabilities could contribute to liquidity problems. As the IMF engages in more structural and development lending, its assets will not only continue to be mismatched against its liabilities, but the IMF will also have fewer resources available when the inevitable liquidity crisis does arise. With total usable quota resources of about $130 billion and a very liberal borrowing guidelines, it is not clear why the IMF would lack the resources for emergencies if it were to reserve the funds exclusively for emergency lending.

In recent months there has been quite a bit of confusion caused by conflicting accounts of IMF finances. Only last week, two top IMF officials provided very different figures on the IMF's remaining resources at the same public news conference. In one recent appearance before Congress, an IMF executive board member displayed a lack of understanding about nontransparent IMF financial statements.

The bottom line is that if top IMF officials find IMF finances confusing and obscure, clarification and transparency are desperately needed. The GAO is to be commended for presenting so many complex accounting issues in such an understandable way, and I believe that Mr. Johnson and Ms. Hecker will be able to explain this very complicated, arcane set of issues in a very simplified way, one which even I can understand. Welcome aboard to both of you.

And Mr. Stark has just come into the room, so let me ask Mr. Stark if he has any comments that he would like to make at this time.

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

OPENING STATEMENT OF REPRESENTATIVE PETE STARK

Representative Stark. Thank you, Mr. Chairman. I would indeed. I would like to thank you. I am sorry I missed your previous hearing, for approaching this in a such a thorough way and attempting to educate the economic unwashed, such as myself, in the intricacies of the IMF. There has been much debate on it, although I understand the debate has been postponed a while. And I would hope that out of your hearings we will be able to get information to our colleagues as to particularly not only the intricacies of the Fund, but also what do our taxpayers get.

I am sure that there are benefits to a small number of enterprises. I guess the real question that I would like to know in the end is, is it necessary to subsidize our five or six largest exporting corporations with the taxpayers' dollars? And if it is, is this the way to do it? I appreciate your trying to get a handle on this and look at it more closely, and I look forward to the testimony today. I hope that the Committee will publish a report, in words of less than a couple of syllables and that I can read without moving my lips, what we are doing. Thank you very much.

Representative Saxton. Thank you very much, Mr. Stark.

Mr. Johnson, why don't you proceed? We normally operate the Committee under the five-minute rule, but this is a subject which deserves very thorough discussion and consideration, so please take the time that is necessary for you to explain the results of the studies that you have embarked on here over the last several months. You may proceed in any way that you see fit.

OPENING STATEMENT OF HAROLD J. JOHNSON, JR., ASSOCIATE DIRECTOR, INTERNATIONAL RELATIONS AND TRADE ISSUES, NATIONAL SECURITY AND INTERNATIONAL AFFAIRS DIVISION, U.S. GENERAL ACCOUNTING OFFICE: ACCOMPANIED BY JAYETTA HECKER, ASSOCIATE DIRECTOR, AND THOMAS MELITO, ASSISTANT DIRECTOR, AND PHYLLIS ANDERSON, SENIOR EVALUATOR

Mr. Johnson. Thank you very much, Mr. Chairman. I will not try and read all 30 pages, I am afraid that would put a lot of people to sleep, but I will try and cover the high points of our testimony and do that in as thorough a manner as possible. Before I begin, though, I would like to introduce Ms. Hecker, who is my colleague on this assignment, and together hopefully we can respond to questions you may have when we complete our presentation.

Representative Saxton. May I interrupt you before you begin in earnest? We have got folks standing along the wall. Unfortunately, we could only get this small room, and we apologize for that.

So let me make two suggestions: Number one, you have some charts that you are going to use. I will make sure everybody can see them, so maybe we can move the charts to the other side of the room.

And if some of you ladies and gentlemen would like to occupy these chairs here in front, in the front podium, that will be fine, too. So help yourselves, and we will try to accommodate you in any way that we can, even though the room is slightly on the small side.

Okay. I am sorry. Go ahead.

Mr. Johnson. A couple of months ago you asked us to evaluate several issues. Among them were the adequacy of public reporting in two areas: one, the finances and financial condition of IMF; and, second, the issue of surveillance or monitoring under Article 4, provisions of the Articles of Agreement.

We have not completed that work yet on either of those issues, including the issue of finances that we are going to discuss today. We hope to have reports on both of those matters available in full later on this fall. But we are prepared today to talk about what resources the IMF currently says they have available to carry out their operations, and whether or not their financial condition can be determined from publicly available documents.

I would like to, by way of background, recite a couple of important concepts that I think we need to understand. One has to do with quotas. Quotas are membership dues that countries pay to join the IMF. Up to 25 percent of the quota normally must be paid in reserve assets, in other words, the special drawing rights or currencies that are "freely usable," hard currency, in other words, dollars, Japanese yen, deutsche marks, et cetera. The balance may be paid in either the country's domestic currency or with a noninterest bearing promissory note.

The portion paid in freely usable currency or special drawing rights is called their "reserve assets" or "initial reserve tranche position" – it is technical, but that becomes important as we go through the discussion. This can be drawn on by the member as needed without prior IMF approval. If withdrawn, these amounts are replaced by the country's own currency so the balance remains the same. Members are not obligated to replenish their reserve tranche positions.

When a country needs additional funds other than those from its reserve position, IMF does not loan the money per se. Rather, according to its Articles of Agreement, the IMF considers that the country has purchased the currency that it needs from the IMF with an equivalent amount of its own currency, and later repurchases or repays using SDRs or other currency, hard currency, on terms that have been established by IMF. Because IMF's financial assistance is in the form of currency purchases and repurchases by members, the financial assistance does not reduce the combined total of IMF's currency holdings in terms of equivalents.

I would also like to briefly mention the accounting standards that IMF uses. According to IMF's External Audit Committee, the opinion that they include in the audit report and our discussions with them, IMF's financial statements are prepared in accordance with generally accepted accounting principles.

However, they have told us that they are not bound by specific legal provisions or accounting principles adopted by any individual member, and indeed they have informed us that the accounting principles referred to in the auditor's report are neither U.S. generally accepted accounting principles nor international accounting standards, but are rather described in a note to the financial statements.

We have not done a complete analysis of all the accounting principles, but we find that they are not materially different. So from that standpoint, many of the accounting procedures are very similar to what we would use in some transactions, although there are differences.

Before I get into the substance of our work, I do need to emphasize that we do not take a position on what action Congress ought to take with regard to the administration's request, nor do we want to comment on policy positions that are outside of our purview.

Also, I need to mention that GAO does not have direct audit authority over the IMF, and that is the case with all international organizations, although IMF has been cooperating with us in this endeavor.

So with that brief introduction, I will summarize before going into greater detail.

IMF has a total of about – and I wanted to mention also that I am going to, for the most part, speak in terms of U.S. dollars, although IMF uses the special drawing rights as their currency equivalent. IMF has a total of about $195 billion in currency holdings in its general resources account that has been provided through quota subscriptions by its 182 members.

However, as of July 20, IMF estimates that only about $130 billion of these funds represent resources that could be used; that is, are from members that are sufficiently strong economically to permit their currency to be used for IMF operations. Of this amount, about $70 billion has already been used to finance credit to IMF members and about $17 billion has been committed for their use. Therefore, according to IMF's estimate, only about $43 billion of their $195 billion in currencies remain available for their operations, including any lending.

Further, IMF and Treasury have indicated in public statements that only about $10 to $15 billion of the $43 billion is available that could be used for additional credit to IMF members without leaving IMF seriously short of funds necessary to maintain certain reserves, and we can discuss that further later. Those IMF estimates do not take into account the $11.4 billion IMF financing arrangement for Russia that was approved on July 20. About $2.9 billion of this $11.4 billion will come from IMF remaining currency holdings, and IMF will borrow another $8.5 billion from the 11 members under the General Arrangements to Borrow.

IMF's available funds are reported annually in its annual report. However, the report is released six months after the end of its fiscal year and is generally considered to be of limited use for decisionmaking purposes. Instead, decisions require the use of IMF's quarterly operational budgets, which are nonpublic.

With that summary, I will go into more detail on the amounts and potential sources of IMF funding.

IMF has several sources available from which it can potentially obtain funds for use in its operations. You have noted some of these. The most important, of course, is the currency holdings provided through quota subscriptions that underpin most of IMF's operating funds. Other sources include the General Arrangements to Borrow and bilateral borrowing arrangements that IMF has created with the members on sort of an ad hoc basis when needed. In addition, IMF could potentially borrow from the private market or sell some of its gold holdings. Some of these resources are clearly more accessible than others, the latter two being fairly inaccessible at this point.

IMF determines its available currency holdings based on its judgment concerning the level of usable currency and the level of reserves needed for contingencies. IMF officials have stated that reserves are necessary for two reasons: one, to maintain sufficient working balances in various currencies to execute foreign exchange transactions; and, secondly, to have funds available in the event that some currencies become unusable and can no longer be used to finance IMF transactions due to a deterioration in the members' balance of payments or external reserve positions.

There are several steps involved in calculating the amount of resources IMF has readily available for operations. First, IMF calculates the amount of currency holdings from quotas, which, as I mentioned, is $195 billion. However, only the currencies of members with sufficiently strong balance of payments positions and gross external reserves are usable by IMF for financing its transactions and are included in the operational budget, which, again, is a nonpublic document.

By the way, the information that we are presenting here today that comes from nonpublic sources has been approved for public release. Because we don't have direct authority, we follow IMF's guidelines in what we can release. And, if there are issues that we need to cover that involve information that they have not authorized us to release, we will address them in private session.

Of the $195 billion of currency holdings, IMF estimates that before taking into consideration its extended credit, it has about $130 billion in usable currency. This is shown on this first graphic. The unusable currencies cannot be used to finance IMF transactions because IMF has determined that the members providing these currencies may experience balance of payment problems if they are drawn down.

Generally, IMF considers about 30 of its members to have sufficiently strong balance of payments positions so that their currencies are considered usable. This is indicated on this second graphic. As you can see, looking at it from a standpoint of what is the available for use, the U.S. contribution is a little over 27 percent, whereas our actual percentage of quotas is around 18 percent, so there is some difference there because of the unusability of certain currencies.

Currencies that are provided from quotas, as I indicated, are recorded in IMF's balance sheet as an asset. The distinction between usable and unusable currency is not reported on the balance sheet, but is discussed in the annual report.

As shown in the table in the text of my prepared statement, IMF then reduces its $130 billion by about $70 billion, the amount of the members' currency purchases outstanding. That is shown also on this pie chart, currencies purchased or drawn, to determine the amount of available resources. Then there is a further reduction based on commitments that have already been made, in this case $17 billion. This leaves the balance available for operations of $43 billion.

I would also like to mention that some of the numbers that you see from time to time change very marginally simply because of the exchange rate that was used. IMF revises the exchange rate on a daily basis, and we tried to use the most current exchange rate available.

Now, there has been considerable discussion and debate about the appropriate level of IMF reserves, the outcome of which leads to estimates of the amount of available resources for IMF operations. In Table 2 in the text of the prepared statement it shows these two different approaches that have been suggested. The results of both approaches have been cited by IMF and Treasury officials in public discussions, and have led to considerable confusion about what is remaining.

Approach one in the table is used by IMF, and I think that they would consider this essentially their official approach. It is an approach that has been approved by the Executive Board to calculate available resources. In using this method, IMF adjusts its available but uncommitted resources by $12 billion for the establishment of a reserve, as required by the Executive Board.

According to IMF documents, this reserve has two components. One component is a minimum working balance that IMF needs to conduct its transactions, and the second component is a reserve of 10 percent of the quotas of members included in the operational budget that are designated for transfer during that quarter in case one or more of these countries may encounter balance of payments problems and can no longer provide its currency as a source of funding for IMF transactions.

After this adjustment is made, IMF would have $31 billion available for operations. That is a number that has been cited publicly by IMF as what they have available for use. However, there is considerable consternation, I would say, at the IMF with our use of that number as compared to the number that results from approach two, and we can discuss that. But let me describe approach two first.

This is another way of looking at what IMF has available for use, and it is a concept that is based on a calculation using liquidity ratio. Actually, it is a calculation that has been made by the U.S. Treasury more so than by IMF, although it is been cited by IMF officials in public statements.

But it is based on a notion that IMF's historical low liquidity ratio of about 30 percent, I think it was actually 29 percent, but about 30 percent, should be the minimum threshold that could be achieved before it would become imprudent to lend. The trend in liquidity ratios is shown on this fourth graphic. As you can see down along the bottom, it is at a point where it is nearly at a historical low level.

In order not to drop below this 30 percent threshold, IMF would have to retain about $30 to $35 billion of its $43 billion in usable but uncommitted resources, and that would leave, using the current exchange rate, $8 to $13 billion. The public statements you have seen indicate $10 to $15 billion, but we are talking about the same calculation.

The $30 to $35 billion adjustment represents the possibility that one or more countries providing usable currencies could draw on its reserve tranche. Countries can draw on the 25 percent reserve tranche on demand, and that is the reason that IMF believes that they needed to retain a reserve for that contingency. And, again, we can discuss that later in the Q and A.

I would now like to move onto other potential resources that IMF has available. I have mentioned several. For example, they may borrow from any source, public or private. One of these borrowing sources is the General Arrangements to Borrow that IMF can use in case of an emergency.

Before the recent activation of the General Arrangements to Borrow for Russia, GAB, and I will refer to it as GAB, was last used by the United States in 1978, to defend the dollar. IMF has also had other borrowing arrangements over the years, notably in the period of 1979 to 1986; I believe there were 14 countries involved in that borrowing. IMF also has 103 million fine ounces of gold which could potentially be used. And it has never, as you have indicated, borrowed from the private market. These available resources are noted in Table 3 in our testimony.

We have a fairly lengthy discussion about the General Arrangements to Borrow. I think in the interest of time I will skip over that and go directly to the New Arrangements to Borrow, since that is the area that Congress is being asked to provide funds. We can discuss the General Arrangements to Borrow in the Q and A, if you would like.

The New Arrangements to Borrow was approved by the IMF Board of Governors in January of 1997 to expand the size and membership of the General Arrangements to Borrow. It would not replace the GAB. However, the New Arrangements would be the facility of first recourse in the event of a need to provide supplementary resources to IMF. The decision to create these New Arrangements grew out of concern, following Mexico's financial crisis, that substantially more resources might be needed to respond to future financial crises.

Under the New Arrangements, the number of participating countries would increase from 11 under the General Arrangements to 25, and the total amount of credit available would be up to $45.5 billion. Now, that is composed of the funds that are available under the General

Arrangements as well as an additional amount of about approximately $23 billion that would be available under the New Arrangements.

The New Arrangements could be activated when participants representing 80 percent of the credit lines' resources determine that there is a threat to the international financial system. And this could make it a little more difficult to activate than the GAB, it seems to us, because the GAB requires only 60 percent approval for activation. But as you know, the New Arrangements have not yet entered into and, of course, will not until the U.S. approves funding for it.

IMF has also borrowed, as I indicated, funds from other official sources. The largest of these was in 1979 through 1981 when it concluded a series of borrowing arrangements with 14 industrial and oil-exporting countries to finance its supplementary financing facility, a facility designed to assist members with balance of payments deficits that were large in relationship to their quotas. So it had a fairly specific purpose.

In 1981, due to the continued high demand for IMF financing, IMF also concluded individual borrowing arrangements with several central banks and the Bank for International Settlements. During the period of '79 to '81, IMF borrowed roughly $31 billion in today's dollars. IMF's most recent bilateral borrowing arrangement has been three billion SDRs from Japan in 1986. There were no current outstanding borrowings until the July 20, 1998, Russia deal.

According to Treasury officials, the option to borrow funds privately was last considered in the early 1980s. They have told us that IMF decided at that time not to borrow from the capital markets for several reasons.

First, it was believed that the cooperative nature of the IMF institution itself might be undermined if IMF began relying on private sources, rather than its membership, for funding its operations. Also, there was a concern about the consequences of having IMF, which seeks to stabilize the international capital markets, relying on those same markets for its funding. And there was uncertainty about whether or not IMF could borrow the amounts that they needed within the time frame that they needed them. So the decision was not made to go to the private sector.

You also mentioned about the IMF's gold holdings. Some have suggested that this could be used for IMF’s operations. As I mentioned, IMF has about 103 million fine ounces of gold which was acquired mostly prior to 1978, when the Articles of Agreement required that 25 percent of the quota subscription be paid in gold and transactions of member countries with the IMF were normally conducted in gold. IMF values its gold on its financial statements at 35 SDRs per ounce, which is about $47 per ounce, which was the price that was set at the time the gold was acquired. Its current market value is approximately $32 billion. This is noted in IMF's financial statements. But, as I said, the balance sheet itself shows the lower amount.

If IMF were to decide to sell some of its gold, it is unclear how much money could be raised, because it is likely that amount put on the world market, at least in large amounts, would cause the price to fluctuate. I would note that IMF did have some auctions of gold in the earlier years. I think there were 44 different auctions, and the price fluctuated substantially during that period of time, from about $190 an ounce to over $700 an ounce, and that was over a four-year period. So there would likely be some fluctuations.

IMF's General Counsel has told us that the Fund does not have authority to engage in other gold transactions, such as loans, leases or using gold as collateral. This is because such transactions are not expressly mentioned in the Articles of Agreement.

I will now turn briefly to the same issue of public disclosure of IMF's financial condition. As I have already indicated, it is not possible in a timely way to determine from publicly available sources what IMF has available for its operations. And when I mention in a timely way, some of this information is noted in its annual report, but the annual report comes out six months after the close of IMF's fiscal year.

Information on the availability and actual use of IMF's resources is regularly provided to its members, including Treasury, in quarterly operational budgets and periodic liquidity reviews prepared by IMF staff. These documents provide considerable detail about IMF's financial condition.

For example, the operational budget specifies the amount of usable currencies to be purchased, repurchased, and other IMF transactions expected to take place during the period. The liquidity reviews provide information on developments affecting the liquidity, 2-year projections on the use of resources, and trends in liquidity investments. However, as I have also indicated, these documents are not publicly available.

IMF's publicly available quarterly and annual financial statements do not disclose the amount of usable currencies, although this is included annually in the report itself. The amount of usable currencies and commitments IMF is likely to make can be determined using additional nonpublic documents. The publicly available financial statements do not show how the adjustment factors that IMF uses to estimate its liquidity are used.

IMF and Treasury officials have both told us that there are few people outside of IMF that use or rely on IMF's public financial statements for information about IMF's financial condition or its liquidity. And IMF and Treasury officials indicate that most potential users of the financial statements do not consider them very useful for making decisions.

A word about the audits of the financial statements. IMF has received unqualified or clean audit opinions from its External Audit Committee. We have not reviewed the audit work supporting these opinions or assessed the independence of the External Audit Committee.

The External Audit Committee consists of three people who are nominated by IMF members and who are approved by the Executive Board to serve one-year terms. At least one person is nominated by one of the largest six quota holders, and one person is a holdover to serve as chairman for the upcoming year. The External Audit Committee reports to IMF's managing director and to the Executive Board.

To enable the External Audit Committee to express an opinion on the financial statements, it relies on audit work done by a certified public accounting firm which is selected by the IMF managing director. The CPA firm issues an advisory letter to the Audit Committee that contains the firm's opinion on the financial statements. The Audit Committee discusses the work of the CPA firm and reviews work papers for a period of time once a year and then renders its opinion. If the Audit Committee has audit issues or recommendations for improvement, it issues its views and suggestions to the managing director and to the Executive Board.

Again, I would mention that we have not tested the work of the Audit Committee and cannot comment on the reasonableness of their opinion. The IMF has commissioned a study of its internal and external audit and evaluation functions and also how it obtains the external audit, and expects to have a report on these matters in September.

That concludes my fairly lengthy remarks, and I apologize for the length.

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

Representative Saxton. Mr. Johnson, thank you very much for a very thorough explanation. I would like to ask some questions, and in so doing, I would like to refer to your report from time to time, as well as some of the graphics that you have been kind enough to bring with you this morning.

First of all, I think this is an important point to make. On page five you have a graphic. And I wonder if the young lady, if you would be so kind to put the graph up for us. This first graph which you have been kind enough to provide us with shows the total quota that the IMF has available to be $195 billion.

Mr. Johnson. Yes.

Representative Saxton. That is the one, thank you, that shows that the total quota is $195 billion. However, you have indicated that there are some $65 billion of that which you have classified as unusable.

Mr. Johnson. Yes.

Representative Saxton. And I assume that the term "unusable" means just what we all think it does, that those monies for a variety of reasons or for some reasons are not available to be used or to be lent to countries in the normal course of IMF activities; is that correct?

Mr. Johnson. Yes, sir. They are not usable because the economies of those countries are not sufficiently strong and their balance of payments and reserve positions are not sufficiently strong that they can be used. Generally, many of those countries are already creditors. Some are not. Some are in a neutral position with the IMF, but do not have the strength to be able to be – where their currencies can be loaned out. That is the reason that IMF categorizes that block of money as unusable.

Representative Saxton. Okay. So in spite of the fact that these countries are responsible for a quota, the quotas and the monies from the quotas, the currencies from the quotas are set aside and are not considered to be a real asset of the IMF?

Mr. Johnson. Yes, that is correct. But I would mention that while the countries – the specific countries I can't mention, that is part of what they asked us not to disclose, but the list of countries stays fairly constant. But there is some movement at the margin, when countries come into the usable category or move out of the usable category.

Representative Saxton. Fine. Then the chart also shows that, on the positive side, there are some $130 billion which can be used.

Mr. Johnson. Yes, and that is a current number. As I mentioned, there are some countries that move in and out, so that number changes from time to time.

Representative Saxton. Okay. Thank you. Now, if we can move to the graph which appears on page six, which was the second graph that you displayed during your presentation.

Mr. Johnson. Yes.

Representative Saxton. This shows that of the $130 billion that the IMF has at its disposal that 27.3 percent is derived from quotas from this country.

Mr. Johnson. From the U.S., that is correct.

Representative Saxton. And that other countries contribute amounts as shown on the chart.

Mr. Johnson. Yes, that is correct.

Representative Saxton. So the 18 percent that we have heard about as our share, when considered in terms of usable quotas, is really 27.3 percent?

Mr. Johnson. That is correct, yes.

Representative Saxton. Mr. Stark would like to interject.

Representative Stark. The countries that contribute unusable contributions have to put 25 percent of usable funds in, they do – how does that fit? I can't make that balance in these two graphs. Where is the 25 percent of usable funds that—

Mr. Johnson. What has ordinarily happened is that they put the 25 percent in and purchase it out.

Representative Stark. Take it right now?

Mr. Johnson. Take it right out with their own currency.

Representative Stark. Thank you. That is where it is.

Mr. Johnson. Yes. And there are some countries that are in a neutral position, that still have their reserve tranche or part of it still available.

Representative Stark. Thank you.

Thank you, Mr. Chairman.

Representative Saxton. Are all countries making contributions in hard currency for the 25 percent that is required?

Mr. Johnson. They do initially. But as I mentioned, they can draw it directly out, and that is not an unusual situation for a poor country; even to borrow money to make its hard currency contribution, draw it out the next day or the same day, pay it back and become a member of the IMF. The IMF has indicated that they have assisted in that process.

Representative Saxton. Mr. Johnson, there is a chart on page seven which I would like to refer to for just a moment, and I don't believe we have a large graph of this, do we?

Mr. Johnson. No.

Representative Saxton. All right. This chart on page seven indicates again the total usable resources to be $130 billion.

Mr. Johnson. Yes.

Representative Saxton. It also indicates that currency purchases, less currency purchases which – the term "currency purchases" is used —

Mr. Johnson. That is the credit that is outstanding.

Representative Saxton. That is the credit – that is loans that have been made?

Mr. Johnson. That is another way to – that is often – it is often called loans. Technically these are currency purchases, because of the way the Articles of Agreement were initially established and the purpose for which the IMF was initially established. So, that accounting transaction has a fairly long history.

Representative Saxton. All right. But "currency purchases" for purposes of discussion in the United States, on the street, means loans?

Mr. Johnson. That is what it means.

Representative Saxton. Okay. So we deduct the $70 billion. That leaves available and usable resources of $60 billion?

Mr. Johnson. Yes.

Representative Saxton. And the IMF has also made certain commitments to Russia, and perhaps to some other countries, of loans to be made or currency purchases to be made.

Mr. Johnson. That is correct.

Representative Saxton. And you show that here as $17 billion?

Mr. Johnson. Yes.

Representative Saxton. Mr. Stark is going to have a question on that.

Mr. Johnson. That excludes the current Russia deal that was approved on the 20th of July.

Representative Saxton. Okay. And now we get to the bottom, which shows here that the IMF has available and uncommitted resources of $43 billion.

Mr. Johnson. Yes.

Representative Saxton. Thank you.

Mr. Stark?

Representative Stark. In that $17 billion commitment, it is my understanding that countries have an annual borrowing amount and that their cap is two or three times their annual amount.

Mr. Johnson. Yes, the annual amount is 100 percent of quota.

Representative Stark. Okay. And the $17 billion for those people who are borrowing, you indicate anticipated the fact that they can borrow three times that? In other words, if I am correct, let's say that their annual borrowing amount is $100 million. Would they actually have a line that is $300 million that they can anticipate? Is this $17 billion, does this anticipate—

Mr. Johnson. Only if the commitment has been made for those – for those borrowing provisions.

Representative Stark. Is that realistic? Do those countries that are borrowing and have this two and three times their annual limit run right up to the limit?

Mr. Johnson. Well—

Representative Stark. Do we know that? Is it like my wife's credit card, I know what the limit is, and she is there?

Mr. Johnson. Most countries are not near their limit. There are about nine or 10 countries that are at the limit or over.

Representative Stark. And always will be?

Mr. Johnson. I am not sure if always, but current – the current –

Representative Stark. But does this anticipate anything beyond the current period, the $17 billion, this does not anticipate that there will be more?

Mr. Johnson. Well, it doesn't anticipate that there will be more commitments made. If the commitment has been made to exceed the purchasing guideline for the coming year, that would be included.

Representative Stark. This is only—

Mr. Johnson. Agreements that have been reached.

Representative Stark. Okay. Thank you.

Representative Saxton. Thank you, Mr. Stark.

Now on page eight, this graph appears, and this graph recites the same information in a graphic way, and the term "currency purchases" is there. May I just ask you, why in the world would they use the term "currency purchases" when everybody is trying to figure all of this out and we have to stop and clarify what currency? Why don't they just call them loans?

Mr. Johnson. Well, I took a fairly careful reading of IMF's Articles of Agreement as to why this occurred the way it did.

OPENING STATEMENT OF REPRESENTATIVE MAURICE D. HINCHEY

Representative Hinchey. Mr. Johnson, I can't hear you, sir. Would you speak into the microphone, please? Thank you very much.

Mr. Johnson. Sorry. The Articles of Agreement describe the transactions using a scenario that if country A is low on its balance of payments, the procedure is to go to country B that has currency to sell. Country A will then buy the hard currency with its own currency, and eventually repurchase its own currency with hard currency when its balance-of-payments problem has been solved. And when IMF was initially established, that was its primary function, to level out those payment situations, and that has continued.

If looked at it from a very long, historical perspective, they probably weren't considered loans. We consider them loans now because they are no longer for these fairly short-term emergency situations. We think of them in terms of the deals that have been struck with Russia, and Korea, where there are really systemic kinds of problems that IMF and the countries are trying to solve and not short-term emergency situations. They are emergencies, but they are not the short-term kind of financial situation that was initially envisioned when IMF was established.

So, it appears that is why we still have this type of transaction. But as I read the Articles of Agreement, it seems to me that that flows from that.

Representative Saxton. This is based on an older, maybe archaic type of accounting system that is no longer appropriate?

Mr. Johnson. No, I don't think – I wouldn't categorize it that way. It is based on a concept of a credit union, and you have heard this before, that members help members. It was established as a club, and the idea was if a member was in trouble, they would get help, and vice versa. If we are in trouble, we would be helped by other industrialized countries.

I would mention that there are true loans that the IMF conducts and those are under the ESAP program, the structural adjustment facility, and other structural adjustment arrangements that they have. Those are loans.

Representative Saxton. Thank you, Mr. Johnson.

On page nine, there is a chart, a table. I guess it would be known as Table 2, and it takes the $43 billion available, which is here available for operations, and begins to discuss two approaches that the IMF or Treasury – I am a little bit confused – that the IMF or the Treasury uses to find the appropriate level of resources available for operations.

Mr. Johnson. Right.

Representative Saxton. Now, my understanding, and just stop me if I am wrong, my understanding is that approach one has traditionally been used by the IMF.

Mr. Johnson. What we have been told is that this is the official approach, the official method that IMF uses to calculate its available uncommitted resources.

Representative Saxton. So in approach number one, the $43 billion which we transfer from that graph to this table is then adjusted by an adjustment factor of $12 billion.

Mr. Johnson. Right.

Representative Saxton. And is there a logical way that the $12 billion is arrived at?

Mr. Johnson. Yes. There is a requirement for working capital. I believe that is estimated at about $3 billion. And then there is a calculation that is made that is 10 percent of the quotas of those countries that are designated in the operational budget to be transferred during that period, during that quarter.

Not all countries that have usable currency that is indicated in the operational budget are designated for transfer. It is only those countries that are designated for transfer. That comes up to about $90 billion, and 10 percent of that would be $9 billion. And those two numbers combined are the adjustment factor.

Representative Saxton. So that has been a traditional method of computing?

Mr. Johnson. Yes, and it is more than just a traditional method. That is a method that the Executive Board has approved to get to that number.

Representative Saxton. Okay. Now, approach number two seems to be quite different, and it confuses me. Who would use approach number two, if approach number one is the official method used by IMF?

Mr. Johnson. Let me talk a little bit first about approach number one. The concern that was raised by IMF when we had our exit discussion with the Treasury and IMF was that the way we had shown approach number one does not recognize that there may be a need for this reserve for countries that can draw on a reserve tranche positions, which they can do on demand.

Under ordinary banking principles, there needs to be some reserve retained. IMF has considered that the reserve ought to be about 30 percent of the credit that is outstanding, in other words, 30 percent of the $70 billion in credit that is outstanding. That comes to $21 billion. Their view, then, is that the $21 billion ought to be deducted from the $31 billion to get to a figure of about $10 billion, where approaches one and two would come out the same.

Now, what I have just described to you we don't find in any documentation. There is some logic to it, but the logic doesn't tell you how much they ought to retain. In discussing this with the IMF, we queried them as to whether they analyzed whether or not countries are likely to draw during that period.

Representative Saxton. Let me ask a question on that point, since you brought it up.

Mr. Johnson. Yes.

Representative Saxton. Have any countries in the last decade withdrawn funds?

Mr. Johnson. I don't think so. No.

Representative Saxton. Have any countries in recent history or in memory—

Mr. Johnson. Well, the U.S. did in 1978. But, there ought to be some historical data on withdrawals of reserve tranches that could be analyzed in establishing that number. It shouldn't just be an arbitrary number. We don't know what that number ought to be. We have not gotten that far along in our work, in our analysis, but that is, it seems to us, a calculation that could be made by the IMF in establishing what a reasonable reserve for creditor countries that may draw on their reserves should be.

Representative Saxton. Is it likely that a country would withdraw or several countries would withdraw as much as $12 billion?

Mr. Johnson. Well, the $12—

Representative Saxton. There is no history to show that it is likely?

Mr. Johnson. No.

Representative Saxton. All right. Okay. Can we move to approach number two, because it confuses the daylights out of me.

Mr. Johnson. Okay. Approach number two is a method that we understand was used first by U.S. Treasury to determine what, on an overall unadjusted basis, what the reserves ought to be in order to maintain an amount that creditors – the same thing we were just talking about – an amount that creditors could draw on if they took their reserve position out of the fund.

Representative Saxton. What I don't understand – and let me just interrupt you for a minute, if I may – what I don't understand is, we just very carefully concluded that, as best you can figure, it would be unlikely that $12 billion would be needed, and yet approach number two appears to set aside $30 to $35 billion.

Mr. Johnson. Right.

Representative Saxton. And I would just like—

Mr. Johnson. That is based on the notion that the liquidity ratio should not drop below 30 percent. Calculating back from that, based on the outstanding credit, gives you about $30 to $35 billion for required reserves. That is the number that has been publicly noted would be required for reserves.

Representative Saxton. Now, approach number two would also be useful if somebody wanted to make the case that the IMF needed more money from quotas, wouldn't it?

Mr. Johnson. There is always a possibility.

Representative Saxton. Always a possibility. Well, it appears to me that that would be one thing that might be used for. Now you mentioned the liquidity ratio, and you brought with you a very easy-to-understand graph that is on page 10 in the report. It shows the trends in IMF's liquidity ratio from '78 to '98.

For purposes of making sure that we all understand what the liquidity ratio refers to, the percent of liquidity on the left-hand axis or column there would be arrived at through a fairly simple computation, would it not?

Mr. Johnson. It is fairly straightforward.

Representative Saxton. It is fairly straightforward. You take the total quota—

Mr. Johnson. No, it is total liquid assets divided by liquid liabilities, and liquid liabilities in this case would be the reserve tranche or any outstanding loans. The reason that outstanding loans are considered is that under the General Arrangements to Borrow, countries can call in their loan at any time if they are in a financial situation where they need to draw that back. So that is considered a liquid liability.

Representative Saxton. So in simplistic terms, it would mean total assets available to be used—

Mr. Johnson. Usable assets.

Representative Saxton. —divided by outstanding loans and reserves?

Mr. Johnson. And reserves, right.

Representative Saxton. Before we—

Mr. Johnson. What we have here in 1997 and 1998, however, is that there were no outstanding loans.

Representative Saxton. Good point. In 1980, were total usable funds all quota?

Mr. Johnson. No.

Representative Saxton. In 1980, there were borrowed funds that were used—

Mr. Johnson. Right.

Representative Saxton. —to arrive at the liquidity ratio? That is a fairly important point, because today we are talking about all quota because we are no longer – we, the IMF – are no longer borrowing, and therefore today's liquidity ratio considers only quota and no borrowed funds.

Mr. Johnson. Right. In fact, when I looked in IMF's publication number 45, they have a table – and I think your staff has a copy of the table – that indicates that at that time about half, about 49 percent of the outstanding credit consisted of borrowed funds.

Representative Saxton. This is another confusing point that I think should be clarified, and it is confusing. At a recent press briefing, for example, the IMF Treasurer first stated that with the inclusion of the GAB or borrowed funds, the IMF liquidity ratio would increase. Later in the same press conference, the same person asserted that the GAB borrowing knocks down the liquidity ratio.

What would inclusion of borrowed funds actually do to the liquidity ratio?

Mr. Johnson. Well, inclusion of the borrowed funds allows the liquidity ratio to be larger. It doesn't reduce the liquidity ratio, because the denominator increases, but the numerator does not.

Representative Saxton. So that means that—

Mr. Johnson. My staff informs me that I got it backwards.

Representative Saxton. Would you please clarify?

Mr. Melito. The denominator increases, the numerator stays constant, so the liquidity goes down with the GAB borrowing. It expresses the liquidity ratio.

Representative Saxton. So they have more money and the ratio goes down; is that what you are saying?

Mr. Melito. Yes.

Mr. Johnson. Yes.

OPENING STATEMENT OF REPRESENTATIVE THOMAS EWING

Representative Ewing. If they borrow money, then they have less liquidity.

Representative Saxton. If by the same token the International Monetary Fund wanted to make more assets available to be loaned, obviously the General Arrangements to Borrow, the New Arrangements to Borrow, which is a subject of some discussion here in Congress, and the inclusion of other methods of borrowing could be used to provide additional funds; is that right?

Mr. Johnson. Yes.

Representative Saxton. On page 12 there is Table 3. These are funds, as I understand it, that can be made available through borrowing to supplement the quotas.

Mr. Johnson. That is correct.

Representative Saxton. And the General Arrangements to Borrow could provide as much as $22.7 billion.

Mr. Johnson. Approximately, right.

Representative Saxton. And the New Arrangements to Borrow could provide $22.7 billion.

Mr. Johnson. An equal amount, right.

Representative Saxton. And then you have a blank. It says "other borrowing authority.” My understanding is that the Articles of Agreement currently have no limit on such borrowing, and this would be the issuance of bonds.

Mr. Johnson. Well, what is referred to there under "other borrowing authority" are two things. They can borrow bilaterally from other countries, bilateral arrangements, and the guidelines that were once in place allowed 50 to 60 percent of quota levels to be borrowed.

Those guidelines are no longer operational, and the amount is decided on an ad hoc basis, as the need arises. But the reason we don't have a number there is because there is no specific limit on what can be borrowed, either bilaterally or if they decided to go to the private market, which they don't want to do.

Representative Saxton. Now, you mentioned a moment ago that there were some guidelines at one point.

Mr. Johnson. Yes.

Representative Saxton. How much could be borrowed under the old guidelines?

Mr. Johnson. Well, as I read the old guidelines, they allow 50 to 60 percent of total quotas, which indicates about $100 million—

Representative Saxton. $100 billion.

Mr. Johnson. —billion could be borrowed, right.

Representative Saxton. So pursuant to past practice, it would not be unreasonable to put in $90 to $100 billion in that space?

Mr. Johnson. Well, if you look at past practice, they have never borrowed that much. The borrowing has been substantially less than that. Even during the late '70s, early '80s, when borrowing was heavy, they only got up to $30 or $35 billion, so—

Representative Saxton. The point is, however, that there is ample opportunity to borrow, should the IMF make the decision to do so?

Mr. Johnson. That could be done.

Representative Saxton. And it is specifically spelled out in their bylaws or their guidelines that it can take place?

Mr. Johnson. No, it is not. What the guidelines say is that the Executive Board could establish, in the context of the circumstances prevailing at the time, limits expressed in terms of total fund quotas above which total amount of outstanding borrowing plus unused credit lines would not be permitted to rise.

Representative Saxton. You are reading from the financial organization operations of the IMF?

Mr. Johnson. Yes.

Representative Saxton. On page 43, is that where you are?

Mr. Johnson. I am actually on page 50.

Representative Saxton. Let me read the first paragraph or so. It says, Sources and Evolution of IMF Borrowing says, "The IMF has the authority to decide on sources, timing magnitude, terms, maturity and techniques of borrowing. The Fund is permitted to borrow currencies from any source, including from nonmembers and private sources, as long as the member issuing the borrowing currency gives its consent."

Mr. Johnson. That is the way we understand it operates.

Representative Saxton. So the point that – can we conclude that the IMF has significant borrowing authority if they decide to use it?

Mr. Johnson. Well, clearly they have borrowing authority. There is some discussion about how that money can be used. The General Arrangements to Borrow are supposed to be used for emergency situations. I don't have the precise wording, but there are some fairly stringent criteria that are laid out in the agreement of what can activate those borrowing agreements. And that is not to say that that can't be changed. The Board of Governors can change that if they decide that is appropriate.

Representative Saxton. Thank you. In your statement, you mentioned that some have suggested that gold be sold. Can you be more specific in terms of who made that suggestion?

Mr. Johnson. You hear it from time to time. In fact, it first surfaced in the early '80s, and Congress asked for a study from Treasury on the implications of selling gold. We finally the other day were able to find a copy of that study, but it is a suggestion that has been made from time to time as a way to generate resources.

Representative Saxton. The gold holdings of the IMF are quite significant, are they not?

Mr. Johnson. They are the second largest gold reserve.

Representative Saxton. The second largest gold reserve in the world?

Mr. Johnson. Yes.

Representative Saxton. Now, I am curious, in the same table that we referred to, it says that on their balance sheet they say, I believe it is $4.8 billion in gold.

Mr. Johnson. Right.

Representative Saxton. My recollection is they actually have $32 billion in gold. Why do they show $4.8 billion?

Mr. Johnson. The current market value is about $32 billion. As you know, the balance sheet includes not only the statement itself, but the notes that are associated with it. And in the note dealing with gold, they do record the market value. But under normal accounting principles you would record an asset at the lower of cost or market, so we don't necessarily see a problem with the way they have recorded gold in their balance sheet.

Moreover, as was pointed out to me yesterday, and my staff can help me here if I get this wrong, but when GAO looked at the financial statements of the U.S. Government, the question arose as to the valuation of gold on the financial statements. And they concluded that the statutory value of about $42 an ounce was the appropriate amount to record on the financial statements of the U.S. Government. So, I don't necessarily think there is an issue with the amount that IMF shows on its financial statements.

Representative Saxton. The only point that I want to make is that the IMF has assets, and when we talk about—

Mr. Johnson. Oh, clearly.

Representative Saxton. —when we talk about the level of assets that the IMF has, using a figure that was derived 50 years ago to determine what the assets are in terms of our 1998 conversation, it seems to me that this is at a minimum confusing, and that everyone should understand that this $4.8 billion is really $32 billion in terms of current market value.

Mr. Johnson. Yes, you are right, but unfortunately that is the nature of financial statements. They record things historically. Hopefully they try to clarify it in a note to the financial statements.

Representative Saxton. Let me just ask one other question about gold. Some have suggested that the gold be sold. My feeling is that if gold were sold in enough volume or enough of the asset to make some difference to the IMF, it would have some negative effect on commodity prices, particularly the price of gold.

Mr. Johnson. It would have to be stretched out over a fairly long period of time.

Representative Saxton. So it would not be a really viable option?

Mr. Johnson. Yes. Even an announcement, it is hard to predict what the market might do, but even an announcement they are going to sell gold could drive the price down.

Representative Saxton. So we wouldn't want to make anybody think that was a good idea.

Mr. Johnson. That is right.

Representative Saxton. I wouldn't want to either. Thank you.

In your statement, you made the critical distinction between usable and nonusable quotas.

Mr. Johnson. Yes.

Representative Saxton. Once again, we want to make sure that everybody understands that point. On pages 29 and 30 you indicate that it is not possible in a timely manner to determine from publicly available sources what the IMF has available for operations.

Why shouldn't taxpayers and Members of Congress and private analysts have access to this information?

Mr. Johnson. I can't think of a good reason why you shouldn't have access to it. It is a number that could be available. It is made available annually in the annual report, and I don't know of a good reason why that number shouldn't be available. It is a number that is found in the operational budget, and I think your question goes more to whether or not the operational budget ought to be made public. And that is a little different kind of issue.

GAO historically has favored openness. Our past Comptroller General testified on numerous occasions about the need for openness and accountability in government, and the need for taxpayers to know what the finances of the government are. So in terms of openness, I think that is a historical position that GAO has taken.

There are some contents of the operational budget, however, I would argue should not be made public. So there is a possibility that an abridged version of the operational budget would be very useful. We haven't really discussed that at Treasury or at IMF. There may be other reasons that even that wouldn't be appropriate. But there is market-sensitive data that affects individual countries in the operational budget that I would argue should not be made public, even given GAO's tradition position on openness in governmental functions.

Representative Saxton. I totally agree with you on that. I am going to ask you another question, and we are going to move onto Mr. Doolittle, because I have taken more than my share of time.

The IMF transparency code states that budget estimates should facilitate policy analysis and promote accountability. Do the public IMF financial statements satisfy this definition of transparency?

Mr. Johnson. No, not really.

Representative Saxton. They do not?

Mr. Johnson. Not in my opinion. I would caveat that by saying that we are not finished with our analysis yet, but it doesn't have the same kind of transparency that is suggested in the standards that IMF is trying to get countries to adopt.

Representative Saxton. That would make it somewhat difficult for analysts, people in academia, policymakers, those of us who are being asked to vote for additional quota, provide additional quota, it would make it difficult for us to make a decision, wouldn't it, based on the lack of evidence?

Mr. Johnson. Based on publicly available documents. But Treasury does have that information available and it can be made available in a closed context. GAO has traditionally, like I said, favored openness to the extent that that can be done, and I believe that is what you are suggesting as well, that openness ought to prevail.

Representative Saxton. Openness ought to prevail, that is right, and it ought not to be limited to just policymakers, but people who are in the field of knowing something about economics ought to have access to it even if they are not policymakers.

Mr. Johnson. One would think.

Representative Saxton. Thank you. Thank you very much.

Mr. Doolittle?

OPENING STATEMENT OF REPRESENTATIVE JOHN DOOLITTLE

Representative Doolittle. Mr. Johnson, the discussion on the ability of the IMF to go out and sell bonds, they have never done that, right?

Mr. Johnson. Yes, that is correct.

Representative Doolittle. Any idea of why?

Mr. Johnson. Well, they have been reluctant to do that primarily because they believe the institution itself is an institution of members, and they ought to rely on their members to support financially the needs of the institution. There are some other tangential reasons, but that is the primary one.

Representative Doolittle. Wasn't there a recommendation by something called the Brandt Commission to go ahead and tap funds in the bond market?

Mr. Johnson. Yes.

Representative Doolittle. Could you explain to me what the nature of that Commission was, how its recommendation came about, and maybe why it wasn't followed up on?

Mr. Johnson. I am not sure I know the history of the Commission itself. I have read the report. But, again, the recommendation that they had was that it at least be tested, and I don't know why it wasn't. It was never followed up on.

Jayetta, do you have any information?

Ms. Hecker. No.

Representative Doolittle. Well, Mr. Chairman, I would be interested just as a Member of the Committee, in further learning about that issue.

Mr. Johnson. We will follow up on that.

[Answers to Representative Doolittle's question on the IMF appear in the Submissions for the Record.]

Representative Saxton. Just for the record, Mr. Johnson listed three reasons that the IMF gave—

Mr. Johnson. Yes.

Representative Saxton. —during this extended conversation. One was the cooperative nature might be undermined; I guess that is what you just said.

Mr. Johnson. I think that is the primary one, right.

Representative Saxton. And that members expect to pay quotas. Therefore, since there is an expectation that when you get into the IMF, you are expected to pay your quota, then that means that borrowing should not occur, which seems like kind of a wishy-washy reason to me. But that is just my thought.

Second, that the consequence of IMF borrowing may have something to do with monetary stability globally. And the third has something to do with how quickly funds could be accessed through the borrowing process.

Mr. Johnson. Right.

Representative Saxton. It seems to me that we have been a year trying to decide whether or not we are going to belly up more quota, and certainly within that kind of a time frame, borrowed funds through bonding or whatever could certainly occur, couldn't it?

Mr. Johnson. Yes. That is why I suggested that the reason that I mentioned was probably the primary reason. The other two could be dealt with in one way or another. The concern about market access in a timely manner, I am sure arrangements could be made if they made the decision to go that route. But the fundamental question is whether or not that has been the approach that the member governments want to take to raise money.

And if the decision were made to do that, then the other two issues that were mentioned in our statement, I believe, could be overcome. Jayetta may have some view on that as well, but—

Ms. Hecker. We have begun some discussions with the private sector about this question, and the reaction that we have gotten is that the key issue is what would back it up.

Representative Saxton. Say that again.

Ms. Hecker. What would back the bonds or issues up. And in the case of the World Bank, when they go to the market, it is very clear policy and it is very well established that the full faith and credit of the member countries are backing it up, so that there is a like a contingent liability, if you will, by the members backing up those bonds.

So the issue here for the folks in the markets that we spoke with is that new procedures would clearly have to be required, and there would be a market judgment of the adequacy of the commitment of the member countries to back it up.

The one possibility raised by some of the market participants was that they could use the gold as collateral, and we talked to the General Counsel of the IMF, who told us that in his view that they could not use the gold to collateralize lending. So that would be a feasibility issue which we haven't really thoroughly examined at all. But that certainly is a key factor in the ability to raise the funds, what the market would say is behind it.

Representative Saxton. Thank you.

Mr. Johnson. I would just mention that, as you may know, the World Bank and the other multilateral development banks go to the market for funds, but they have been provided with a large amount of callable capital that allows them to maintain a AAA rating.

Representative Saxton. Yes. I am sorry, I apologize to Mr. Doolittle, I stole half of his time or whatever. If you have more questions, why don't you proceed.

Representative Doolittle. Well, maybe this isn't really the place to get into it. I am intrigued by the moral hazard question posed by the IMF. In fact I really – I know in an earlier hearing we had some fascinating testimony by George Shultz. You know, why do we need an IMF? Is there still a compelling reason to have an IMF today?

Mr. Johnson. I am afraid that goes beyond the scope of our work. And we probably all have some opinions about it, but—

Ms. Hecker. Well, we did a review after the problems with Mexico of what lessons were learned, and then did an evaluation for the Congress of some of the new measures that were being proposed, basically the NAB and some improved data dissemination. And in evaluating the impact of those improvements to improve either the better anticipation or avoidance or resolution of crises, there were inherent limitations in all of those activities.

The key problem that we said needed to be evaluated in any intervention is in fact the moral hazard. And that simply is that an action, the lending, could in fact have the perverse effect of increasing the risk-taking activity in the private sector, or in some they say it could increase the activity of the government taking more risk. So there is a lot of debate about moral hazard. There isn't real consensus about it, but there is substantial reason to believe that it is something that there ought to be concern about and weighing before any single intervention whatsoever.

Representative Doolittle. Well, our government taxes money out of the private sector, and then we transfer some of that to the IMF and they loan it to others, and I guess we get an IOU from the IMF that represents the value of the resources transferred to it. And I just wondered if either one of you would assess in the foreseeable future, what do you think the probability is that a significant amount of those IOUs will be returned with cash to the U.S. taxpayer?

Mr. Johnson. Well, up to now the U.S. has not lost money on these loans.

Representative Hinchey. Mr. Johnson?

Mr. Johnson. I am very sorry.

Representative Hinchey. I can hear Ms. Hecker very well.

Mr. Johnson. But up until now, all the loans have been honored. The loan agreements is between the U.S. and the IMF. On purchase, it is slightly different.

As you may know, there is currently an initiative that is being sponsored by the IMF and the World Bank for heavily indebted poor countries to provide loan forgiveness, so there is potential that loans will not be repaid from some of those.

The Enhanced Structural Adjustment Program are loans only, but insofar as the purchases are concerned, the U.S. is paid interest on the amounts. And while our cost of money is slightly more than the interest that is paid, it is very slight, very marginal.

Representative Doolittle. Thank you, Mr. Chairman.

Representative Saxton. Thank you.

Mr. Hinchey?

Representative Hinchey. Thank you very much, Mr. Chairman. This has been a very interesting exercise, and I really appreciate you calling this hearing.

And, Mr. Johnson, thank you very much for your testimony. It has been fascinating. I would direct your attention once again to figure number 4, which was the figure showing the liquidity ratio, 1978 to 1988.

Mr. Johnson. Yes.

Representative Hinchey. And I just want to state the obvious, that the precipitous drop in the IMF's liquidity ratio from 1994 to 1997 came about as the result of the necessity of the Fund to put its resources into operation.

Mr. Johnson. It was a lot of money paid out, right.

Representative Hinchey. And that is primarily a result of the East Asian financial crisis, I assume.

Mr. Johnson. And Russia.

Representative Hinchey. And Russia.

Mr. Johnson. And Mexico.

Representative Hinchey. And Mexico, absolutely.

Mr. Johnson. I think there are nine or 10 countries.

Representative Hinchey. Pardon me, sir?

Mr. Johnson. There are nine or 10 countries that have most of the money out, and that is fairly recent.

Representative Hinchey. And the liquidity ratio as reflected for 1998, the number which is something in the neighborhood of, I guess, 40 —

Mr. Johnson. It is around 44 percent right now.

Representative Hinchey. 44. Does that take into account the latest funding to Russia?

Mr. Johnson. No, it does not.

Representative Hinchey. So the liquidity ratio is actually lower than what is represented by this chart?

Mr. Johnson. Yes, it is lower.

Representative Hinchey. How much lower?

Mr. Johnson. Well, it is 29 percent.

Representative Hinchey. Pardon me?

Mr. Johnson. It would be 29 percent.

Representative Hinchey. It would be down to 29 percent?

Mr. Johnson. Yes.

Representative Hinchey. It would just be above the bottom line there, which is 25?

Mr. Johnson. I am sorry?

Representative Hinchey. The bottom line is 25. It will be just above that bottom line, no?

Mr. Johnson. That is correct.

Representative Hinchey. I am getting a correction here, Mr. Johnson.

Ms. Anderson. I just wanted to elaborate a little bit further. It would be about 36 percent if you include the $2.9 billion commitment that was made to Russia as well as the $8.4 billion they are borrowing through GAB.

Representative Hinchey. Then it would be at what level?

Ms. Anderson. About 36 percent.

Representative Hinchey. About 36 percent?

Ms. Anderson. Yes, as of July 22, 1998.

Representative Hinchey. If you included all of the funds that have been committed to the Russian situation currently?

Ms. Anderson. Yes.

Representative Hinchey. And of course the funds that have been committed to the Russian economy currently are about half or less of what they have requested; is that correct? You may not know the answer to this question, but I think that is roughly accurate.

Coincidentally, we had the semiannual Humphrey-Hawkins hearing in the House Banking Committee yesterday, and Mr. Greenspan was asked a question with regard to the IMF at that hearing. And he said that the amount of IMF's resources available for program lending was, and I quote, at rock bottom. He also said that many of the concerns over IMF transparency are legitimate and should be addressed after the quota increase has been approved.

Does that make sense to you?

Mr. Johnson. The latter part of that does.

Representative Hinchey. The latter part of it makes sense to you?

Mr. Johnson. Right. The resources are low, clearly they are low. I don't know if they would be a historical low level. But the question is how those resources should be replenished, whether through a borrowing or quotas or other sources, but—

Representative Hinchey. That is a legitimate question; how they should be replenished is a legitimate question.

Mr. Johnson. Certainly they are low.

Representative Hinchey. Could I ask you to look at figure number 3, which is the pie chart, which is a breakdown of estimate of usable currencies—

Mr. Johnson. Yes.

Representative Hinchey. —as of July 20, this year. So we determined that as a result of the questions of our chairman, Mr. Saxton, that the term "currency purchases" is actually outstanding loans, or at least those two phrases are interchangeable.

Mr. Johnson. Yes.

Representative Hinchey. The reason for that is that outstanding loans occur in the following way: They are not actually loans. They are in fact purchases of the currency of the needy country by the IMF. In the case of Russia, they purchased Russian currency in the amount of the stated loan; is that correct?

Mr. Johnson. They purchased hard currency with Russian currency, with rubles.

Representative Hinchey. Okay. They purchased hard currency with rubles, and that amount of money is provided to the Russian economy?

Mr. Johnson. Right. The hard currency or SDRs. I am not sure what the breakdown is.

Representative Hinchey. That is currency purchases and outstanding loans. Expected to be drawn, that figure which represents

$17 billion, that is actually committed funds for loans not yet disbursed; is that correct?

Mr. Johnson. Right.

Representative Hinchey. So that money is spoken for?

Mr. Johnson. Yes.

Representative Hinchey. That is tied up?

Mr. Johnson. Those are commitments that have been made.

Representative Hinchey. Those are commitments that have been made. That is another $17 billion. And the $43 billion which is labeled "available for operations" actually is an amount of usable funds prior to the Fund's reserve, which you report in your testimony somewhere between $30 and $35 billion?

Mr. Johnson. That is one method of calculating what is needed for reserves.

Representative Hinchey. In fact, there are two methods of calculating, as we have seen. You have demonstrated that for us.

Mr. Johnson. Right.

Representative Hinchey. But both methods of calculation have been determined acceptable?

Mr. Johnson. Yes, the difficulty I guess with both methods of calculation is that there is not a documented analysis of what that reserve level ought to be.

Representative Hinchey. Yes, okay. So we have now $43 billion prior to the Fund's reserve, and the Fund's reserve, we estimated it somewhere between $30 and $35 billion, so what we have left then is between $8 and $13 billion.

Mr. Johnson. Under that method, right.

Representative Hinchey. So the amount of money that is currently available for use, practical use, is between $8 and $13 billion?

Mr. Johnson. Well, I wouldn't want to be categorical about that, because one doesn't know how much of the reserves they actually need or can go into. And that is part of what the argument has been about, is the level of reserves that are required. You know, when you look at the —

Representative Hinchey. Well if you were a prudent person, you would want to have a substantial amount of reserves available to you, especially if you were looking at a global economic circumstance similar to the one we are currently addressing.

Mr. Johnson. I can't argue with that.

Representative Hinchey. You can't argue with that, can you? That is perfectly true.

Mr. Johnson. Yes.

Representative Hinchey. So $30 to $35 billion, given the present circumstances of the global economic situation, doesn't seem to be too outrageous, does it?

Mr. Johnson. That reserve would not necessarily be available for that purpose. These reserves are to be used in the event a country that has not drawn on its reserve tranche would draw on it. In other words, if the U.S. decided that we needed to draw on that reserve tranche, that is what these reserves are for.

Representative Hinchey. So what you are saying is that those reserves aren't entirely liquid in terms of the availability of money for other countries to borrow from?

Mr. Johnson. They are liquid, but the analysis that we suggest needs to be made – we haven't done this yet because we are not that far along in our work – but the analysis that seems to me needs to be done is to look at the amount of reserve tranches that have not been drawn, and make an analysis-based judgment about the likelihood that the reserves would be drawn and calculate a reserve withholding on that basis, rather than just arbitrarily pick a number based on a ratio.

Representative Hinchey. Okay. Well, that makes sense. There should be a closer analysis to determine what effective reserves ought to be held.

Mr. Johnson. Right.

Representative Hinchey. But the holding of reserves is something that is very prudent. It is done by every single bank.

Mr. Johnson. Every single bank. That is a fundamental principle of banking.

Representative Hinchey. Fundamental and basic. So there has got to be a reserve. $30 to $35 billion may be arbitrary. We can argue about a billion here and a billion there. Even if we did, if we decided that it was – that $35 billion was a little bit too high, that it had to be $25 billion, that would mean that only $23 billion would be available?

Mr. Johnson. Yes.

Representative Hinchey. Or less. The fact of the matter is, there is only a finite amount of money that is available. It is somewhere in the range, currently under these reserve situations, between $8 and $13 billion. That is what is available.

Now the concern arises, of course, because we are in a very delicate economic circumstance. We don't know what the Asian economic crisis is going to do. The Chinese may devalue their currency tomorrow or next week or next month. That is going to have major repercussions. So we are in a very fluid situation in terms of the world economy. It would be advisable to be very prudent in this circumstance, don't you think?

Mr. Johnson. Sure.

Representative Hinchey. The estimates which you present this morning of the funds currently available to the IMF for its programs are very similar to those reported by the IMF itself.

Mr. Johnson. These are—

Representative Hinchey. They are right on target.

Mr. Johnson. These are the numbers that IMF and Treasury used. The problem has been that they used both sets of numbers in public statements and created a bit of a confusion.

Representative Hinchey. And the Fund itself discussed these numbers at a press conference it held recently, and those are exactly the same numbers which were discussed at that press conference?

Mr. Johnson. Yes, but when you read the transcript, there was obviously confusion even among the top level of IMF as to what they had.

Representative Hinchey. It was a statement with regard to a figure and then that figure was corrected.

Mr. Johnson. The figure that IMF said was correct was that it had $31 billion available. That was—

Representative Hinchey. $31 billion available?

Mr. Johnson. Right.

Representative Hinchey. Yes, they have $31 billion available, if they were to use up all of these reserves. There is no point in getting into a semantic discussion here.

Mr. Johnson. I understand that, right.

Representative Hinchey. So if they were to use up all of their reserves, the amount of money available would be $30 billion roughly. If they didn't use all of their reserves, given that amount of reserves, $30 billion, the amount of available funds would be about $8 billion?

Mr. Johnson. If they decided that they needed—

Representative Hinchey. That they needed those reserves.

Mr. Johnson. Those reserves, right.

Representative Hinchey. Of course, that is the point. They have to have reserves, every financial institution. Every bank, anybody with any sense, all of us have some reserves.

Mr. Johnson. I can't quarrel with that notion.

Representative Hinchey. So the question is how much is the reserve, and $30 billion in this particular context I think would seem to be a prudent amount. Alan Greenspan said they reached rock bottom. That is his interpretation of where they are. We might quibble with that, but that is his interpretation.

And also these amounts were published in a number of magazines, including the *Economis*t, which is a magazine with probably one of the world's largest circulations. So we all have a pretty good idea about what is happening here, don't we? We all know these numbers pretty well.

Mr. Johnson. They have certainly been in the public domain.

Representative Saxton. I would just, if the gentleman would yield for a moment, it has taken us – the gentleman is – it has not been a simple process to get to where we now think we know what the numbers are. It has taken a year, and it is – as a matter of fact, the gentleman just referred to the press conference that the IMF held with First Deputy Managing Director Stanley Fisher and IMF Treasurer David Williams. They openly differed on what they believed to be resources currently available to be used by the IMF. At one point Mr. Fisher said, "Let me get this straight. We have $44 billion," and he was contradicted by Mr. Williams.

So this is not something that has – the conclusions that we have reached pursuant to your studies, and now have apparent agreement by the IMF, I have been studying on these issues for a year, and it has taken me a year to come to the conclusion that we now apparently agree. And even after we reached agreement on the $43 or $44 billion number, we are now having a debate on whether the resources available for operations are $31 billion or $8 to $13 billion.

Representative Hinchey. Mr. Chairman, recovering my time—

Representative Saxton. These issues are not clear.

Representative Hinchey. —I certainly don't want to diminish or demean in any respect the work that you have done on this issue, because I think it is very, very important. I think that the IMF up until recently has been a very mysterious operation. Whether that is been conscious on their part or not, or just because people weren't paying attention to it, really is beside the point. The fact of the matter is now we know a lot more about it as a result of the inquiries raised by our chairman here. The work that you have done, I assume at his request, all of that has contributed immensely to our knowledge.

But it is also true that whenever any one of us, Members of the House of Representatives, almost every time we make a statement on the floor, we append to that the statement that we would like to revise and extend our remarks because some of us are prone to making mistakes. Now, I know that happens, and I think that is probably what happened at this press conference the other day when one number was given and then that number was corrected. But my point is, we now have a very good understanding of what these – what the amount of money that is available through the IMF actually is.

Representative Saxton. We have, Mr. Hinchey, if I may just – I am sorry to have to do this, but we have a vote on and we also have two Members who have not had an opportunity to ask questions yet, and I am told by staff that we are supposed to vacant this room at 12:00 o'clock. So we have some barriers that are here in front of us.

Mr. Ewing and Mr. Sanford, do you want to take a minute or two here to ask some concluding questions?

Representative Ewing. Thank you, Mr. Chairman, and thank you for holding this hearing.

A couple of questions I suppose I should know, but I don't, but when the Russians come to the IMF they have a right to get so much money. It has to be approved. Is it their money they are getting back, that they paid in? I don't understand the situation.

Mr. Johnson. They have a right to their reserve tranche position; that is 25 percent of their quota. They can take that back at any time they need it. I presume that that occurred long before we got to this current point. Beyond that, any arrangements that are made have to be approved by the Executive Board. And those are negotiated, and different funding facilities in this case were used in order to apply the conditions that were necessary to reach the arrangement with Russia.

Representative Ewing. The IMF is not like a bank where you go in, you have to justify that you have a legitimate economic reason for the loan? I mean, it is there to help countries that are in trouble.

Mr. Johnson. Well, it is. They also have to come in with a program on how they are going – explaining how they are going to get out of trouble. When they come to the IMF, they are supposed to come in with a proposal on how they are going to rectify their situation over a period of time.

Representative Ewing. One final question: Have you studied whether that was actually followed in the most recent cases?

Mr. Johnson. We have not.

Representative Ewing. Okay, thank you.

Representative Saxton. Mr. Sanford?

OPENING STATEMENT OF REPRESENTATIVE MARK SANFORD

Representative Sanford. I will just leave three questions with you that you may answer. Unfortunately, I may have to leave before you are able to answer them.

First would be, I was in a meeting with Stanley Fisher a couple of weeks ago, and there was real confusion – even with Stanley Fisher – about what is the mandate of IMF. Because when we actually begin to talk about the Russian loans, for instance in essence it became an exercise in nation building. We were told that Russia was of such importance to us that we, quote, “had to do it” despite the fact that there had been no real market reforms in Russia. And I would be curious to hear your comments on that.

Second, I would be curious to hear your thoughts on cost. Secretary Rubin has consistently said that IMF replenishments have no cost to the United States taxpayer. I do not believe that to be the case, because if you look at the cost of capital, you look at what international lenders are charging in interest, for instance in Southeast Asia, versus the rate America is charging, that difference is called spread. And if American taxpayers were to take those same sums of money and invest them, they would normally get a market rate. Since we are not getting market rates, there is a real and imputed cost to the American taxpayer, and I would be curious to heard your thoughts on that.

And, thirdly, I would be curious to hear your thoughts on, quote, “IMF as a lender.” In other words, if this is traditional lending, we ought to have a time when the loans are repaid. Is it a 10-year loan, a five-year loan , a 20-year loan? That doesn't seem to be the case. So how can this be called, quote, “a loan” to the IMF, when we don't have a takeout?

Representative Saxton. Mr. Sanford, thank you very much.

Representative Sanford. I would be pleased to have answers for the record. Mr. Chairman, you have to leave to vote.

Representative Saxton. I have to vote and we need to vacate the room. Would you be willing to answer those three questions in writing for us?

Mr. Johnson. Yes, absolutely.

[Answers to Representative Sanford’s questions on the IMF appear in the Submissions for the Record.]

Representative Sanford. Thank you.

Representative Saxton. Mr. Johnson, Ms. Hecker, thank you very much for what you have done here over the past several months, and particularly for today. It is my belief that I know more now, and I think Congress now has access to information about the IMF that has never been available to it before. In other words, we know more about the IMF today than we ever have in the history of the IMF, and we thank you for the very important part that you have played in getting us to where we are.

Thank you very much.

[Whereupon, at 11:55 a.m., the hearing was adjourned.]

SUBMISSIONS FOR THE RECORD

PREPARED STATEMENT OF REPRESENTATIVE JIM SAXTON, CHAIRMAN

I am pleased to welcome Mr. Johnson and his colleagues from the General Accounting Office (GAO) here before the Committee this morning. I would also like to thank the GAO team of economists and accountants that has reviewed the finances of the International Monetary Fund (IMF) for the last several months.

Since last fall I, along with a number of others here in Congress, have been pushing for more IMF transparency. While this has resulted in some additional information being released, Congress still has not been provided with an adequate explanation of IMF finances and operations.

The time has come for Congress to take action on its own and use the means at its disposal to provide increased transparency at the IMF. As a result of this hearing, more factual information about the finances of the IMF will be in the public domain than ever before. This will enable all of us to take a fresh look at the IMF and examine the financial issues with an open mind. While reasonable people may disagree over various issues related to the IMF, there will now be a better understanding of IMF finances on all sides.

Three main issues to be discussed today appear to be among the most important: the amount of resources the IMF has access to; the degree to which the IMF can address its own liquidity needs; and the mismatch in IMF assets and liabilities related to its evolution into development and structural lending.

First, the facts presented today show that the alleged impoverishment of the IMF is more than a bit exaggerated. The IMF holds $43 billion in usable quotas, $32 billion in gold, and can borrow up to $23 billion under the GAB. Thus the IMF holds or has access to about $98 billion, a tidy sum even if not all of it can be loaned. Moreover, the IMF can borrow huge sums from private financial markets; $60 billion would be well in keeping within historic guidelines. Even if the Russian loan is fully disbursed in compliance with loan conditions, the IMF would have quite a kitty of about $80 billion, not counting private sector borrowing.

Second, the IMF is not helpless to address its liquidity needs. As noted, the IMF can sell bonds to raise money and provide usable resources for operations. The IMF's liquidity ratio, which we will hear about shortly, can be used to portray an impoverished IMF. But this argument is often presented without mentioning the fact that the IMF can raise funds not even counted in the ratio by issuing bonds. Moreover, the changing financial structure of the IMF over time makes the validity of historical comparisons of the liquidity ratio very dubious unless these structural changes are taken into account.

Third, the IMF has evolved from an institution with liquid assets and liabilities to one in which assets have become longer term, but liabilities are still very short term. This mismatch of assets and liabilities could contribute to liquidity problems. As the IMF engages in more structural and development lending, its assets will not only continue to be mismatched against its liabilities, but the IMF will also have fewer resources available when the inevitable liquidity crises do arise. With total usable quota resources of $130 billion and very liberal borrowing guidelines, it is not clear why the IMF would lack the resources for emergencies if it were to reserve its funds exclusively for emergency lending.

In recent months there has been quite a bit of confusion caused by conflicting accounts of IMF finances. Only last week, two top IMF officials provided very different figures on the IMF's remaining resources – at the same public news conference! In one recent appearance before Congress, an IMF Executive Board Member displayed a lack of understanding about non-transparent IMF financial statements.

The bottom line is that if top officials find IMF finances confusing and obscure, clarification and transparency are needed. The GAO is to be commended for presenting so many complex accounting and economic issues in an understandable way.