

CBO TESTIMONY

**Statement of
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Director**

The Costs and Budgetary Treatment of Multilateral Financial Institutions' Activities

**before the
Committee on Banking, Housing, and Urban Affairs
United States Senate**

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Mr. Chairman and Members of the Committee, I appreciate the opportunity to appear today to discuss the costs and budgetary treatment of U.S. support for multilateral financial institutions (MFIs).¹ At the request of the House Budget Committee, the Congressional Budget Office (CBO) has been examining the budgetary presentation of a variety of the federal government's financial transactions. The preliminary analysis that I present today derives from that effort.

The United States supports MFIs to further its international economic and political policy objectives. In the process, it incurs costs. My focus today will not be the benefits of MFIs' operations but, instead, the economic measurement and budgetary presentation of the costs of MFIs' activities. I hope to convey the following key points:

- MFIs lend to countries that have often gone into arrears and sometimes defaulted on their debts to other lenders.
- The operations of MFIs embody subsidies to borrowing countries.
- Some of the features of world financial markets that protected MFIs from loan losses in the past may not do so in the future.
- Therefore, U.S. taxpayers may bear some portion of those costs in the future. The extent of that exposure will depend on the financial structure of the MFI and the laws and institutions that link it, the United States, and other relevant parties and the United States' decision about replenishing the MFI's resources.
- To support well-informed policy decisions, the federal budget should recognize the magnitude of the United States' financial commitments in a consistent fashion, including those of the various MFIs.
- The current budgetary treatment of MFIs may fall short of that goal.

My statement does not attempt a comprehensive survey of MFIs, but rather focuses on three of the most important ones: the World Bank's International Development Association (IDA), which lends at "concessional" terms—providing loans at below-market rates and with very long terms; the International Bank for Reconstruction and Development (IBRD), which undertakes most of the World Bank's "nonconcessional" operations; and the International Monetary Fund

1. MFIs include the International Monetary Fund, multilateral development banks, and several other specialized financial institutions. Such banks include the World Bank, the Asian Development Bank, the Inter-American Development Bank, the African Development Bank, the North American Development Bank, and the European Bank for Reconstruction and Development. Other specialized organizations include the International Finance Corporation, the Inter-American Investment Corporation, and the Multilateral Insurance Guarantee Association.

(IMF). Each MFI poses different economic risks and different conceptual issues for the presentation of U.S. commitments in the federal budget.

The Economic Costs of MFIs' Operations

All loans present risks to the lender of nonrepayment (credit risk); and MFIs lend to particularly risky clients. Member countries that have borrowed from MFIs have often gone into arrears and sometimes defaulted on their debts to other lenders. They have restructured their debts, changed their future debt payment through rescheduling, and sometimes asked for debt forgiveness. For example, since 1990 borrowing members of the three MFIs have rescheduled about \$270 billion of their loans from other governments—a figure that represented almost 60 percent of their nearly \$450 billion in outstanding bilateral debt as of 2002. They have also rescheduled and reduced their debts to private banks. The resulting losses have been estimated at \$61 billion between 1989 and 1995, or about one-third of the private-sector portfolio of \$191 billion in loans to those borrowers.²

Reflecting their credit risk, the debts issued directly by the governments of borrowing member countries—sovereign bonds—trade at a discount below U.S. Treasury securities with similar maturities and coupons. For example, such discounts have reached as much as 35 percent for Brazil and 80 percent for Argentina, both important borrowers from MFIs.

MFIs' lending embodies subsidies to the borrowing countries. The economic magnitude of such subsidies can be gauged by comparing the book values of an MFI's loans—the dollar face value at the time the loans are made—with the corresponding market value. To estimate the market value, CBO used the market prices of borrowing countries' bonds with terms (maturities, coupon payments, and so forth) adjusted to be similar to those of MFI loans.

Several important caveats apply to those calculations. First, as discussed at length below, the use of market prices as a point of comparison assumes that lenders have equal seniority—a level playing field where one lender will not be paid before the others. Second, as with all such valuation estimates, they represent a snapshot; one could choose to make a valuation at several points in time. Third, CBO relied on several simplifying assumptions and approximations, including the adjustments to bonds terms, that were not exact. The results of the calculations are, therefore, best considered as approximations of the relevant costs.

2. William R. Cline, "International Debt Re-examined," in Federal Deposit Insurance Corporation, *An Examination of the Banking Crises of the 1980's and Early 1990's*, vol. 1 of *History of the Eighties: Lessons for the Future* (1995), pp. 234-235.

The International Development Association

Donor countries provide resources through capital subscriptions to IDA. It then lends that money to low-income countries that may have difficulty borrowing on international markets. The loans carry a zero interest rate, or, on occasion, IDA provides funds as grants. As of June 2003, its portfolio of outstanding loans had a book value of about \$115 billion (see Table 1). In contrast, the market value of the loans was only about \$20 billion.³ Therefore, subsidies by IDA totaled about \$95 billion. Of that amount, about \$7.1 billion resulted from lending that occurred in the previous fiscal year.

Table 1.

The International Development Association's Portfolio, June 2003

(Billions of dollars)

	Book Value	Market Value	Difference	Difference as a Percentage of Book Value
Total Portfolio	115.1	20.3	94.8	82.4
2003 Lending ^a	7.3	0.2	7.1	97.6

Sources: World Bank and preliminary estimates by the Congressional Budget Office.

a. Loans made during the World Bank's fiscal year ending June 30, 2003.

The International Bank of Reconstruction and Development

Member countries also pay in capital subscriptions to IBRD. Unlike IDA, however, IBRD increases its capacity to lend to developing countries by selling bonds in international capital markets.⁴ In June 2003, IBRD had \$11.5 billion in paid-in capital and \$108.6 billion in outstanding debts. Those resources helped fund \$116.2 billion in loans to developing countries.⁵ In addition to paid-in capital, IBRD members have agreed to provide another \$178 billion in callable capital. Of that total capital, about \$110 billion is payable by high-income industrial countries.

3. For many IDA borrowers, no sovereign debt is traded in public markets. However, even assuming optimistically that IDA's borrowing members could borrow on the same terms as the United States, the length of loans and repayment schedules yield subsidies over 80 percent. Therefore, the probability of defaults has little influence on the estimated value of the loans.

4. The World Bank also has \$26.4 billion in retained earnings to buffer against defaults without calling for more capital. See World Bank, *Annual Report, 2003*, vol. 1, table 1.

5. World Bank, *Annual Report, 2003*, vol. 1, table 11.

In June 2003, IBRD's portfolio of all outstanding loans had a book value of \$158 billion (see Table 2). The market value of the loans was considerably less—about \$111 billion. Again, the gap between the book value and market value, or \$47 billion, reflects the estimated costs of the subsidies inherent in IBRD's portfolio. Of that total, \$7 billion in subsidies arose from IBRD's \$11.2 billion in lending during the previous fiscal year. Those operations in 2003 give an indication of the economic subsidies in new loans. At the same time that IBRD originated about \$11 billion in new loans, the market valued them at about \$4 billion.

Table 2.

The International Bank of Reconstruction and Development's Portfolio, June 2003

(Billions of dollars)

	Book Value	Market Value	Difference	Difference as a Percentage of Book Value
Total Portfolio	157.8	110.8	47.0	29.8
2003 Lending ^a	11.2	4.3	7.0	62.1

Sources: World Bank and preliminary estimates by the Congressional Budget Office.

a. Loans made during the World Bank's fiscal year ending June 30, 2003.

The International Monetary Fund

IMF assigns member countries "quotas," or capital subscriptions. Members pay their quota in two components. First, about a quarter is in highly liquid currencies, easily converted to other similar currencies. The remainder is in notes denominated in the member's own currency. Altogether, IMF members have paid quotas totaling about \$300 billion.⁶ In exchange, member countries have the right to withdraw the highly liquid currencies that they paid in and to borrow such currencies beyond what they paid in.

When countries draw beyond their paid-in quotas, the terms for such loans vary, with repayment periods ranging from two years to 10 and interest rates starting from a basic rate (at present, about 2.7 percent) and adding as much as 800 basis points (8 percentage points) for loans that are large relative to a member's quota.⁷

6. International Monetary Fund, *Financial Statements of the International Monetary Fund, Quarter Ended January 31, 2004*, Balance Sheet, p. 3.

7. *How Does the IMF Lend: A Factsheet* (April 2003), available at <http://www.imf.org/external/np/exr/facts/howlend.htm>; and SDR Interest Rate, Rate of Remuneration, Rate of Charge and Burden Sharing Adjustments, May 16, 2004, available at <http://www.imf.org/external/np/tre/sdr/burden/2004/051004.htm>.

For many member countries, the economic advantage arising from membership in IMF lies in being able to effectively exchange their own currency for highly liquid foreign currencies. Suppose, for example, that the government of Argentina needed to make a payment on non-IMF international debts denominated in dollars. The government might perceive that buying the necessary dollars using Argentine pesos on international currency markets would adversely affect the dollar/peso exchange rate. If so, the government could borrow dollars from IMF, leaving the peso/dollar exchange rate unaffected, even as Argentina used those borrowed dollars to settle its debt obligation.

How does such a transaction entail an economic cost? The main potential for subsidy arises when IMF lends strong, liquid currencies, such as the dollar, and gets in exchange from the borrowing countries promissory notes for repayment two to 10 years in the future that they may be unable to fully honor.

In June 2003, IMF had a portfolio of outstanding loans with a book value of \$121 billion. However, valued using the market prices of comparable private-sector bonds, the portfolio would be worth \$60 billion. That is, IMF members lent \$121 billion in exchange for assets with an estimated value of \$60 billion and thereby provided subsidies of about \$61 billion. Of that amount, \$6.4 billion arose in the previous fiscal year, when IMF made loans of \$41 billion that had a market value of roughly \$35 billion.

Table 3.

The International Monetary Fund's Portfolio, June 2003

(Billions of dollars)

	Book Value	Market Value	Difference	Difference as a Percentage of Book Value
Total Portfolio	121.4	60.1	61.3	50.5
2003 Lending ^a	41.1	34.8	6.4	15.5

Sources: International Monetary Fund and preliminary estimates by the Congressional Budget Office.

a. Loans made during the International Monetary Fund's fiscal year ending June 30, 2003.

Estimating the U.S. Share in the MFIs

An important step in assessing the potential treatment of U.S. commitments in the federal budget is gauging the magnitude of the country's role in MFIs. The size of the United States' share depends on its share of the capital or of the quotas of the MFI in question. Those shares are set out in MFIs' articles of agreement and in their boards of governors' resolutions.

For IDA, since all funds are actually paid in, the United States' share is a relatively unambiguous 21.7 percent.

For IBRD, the United States' nominal share of paid-in and callable capital is 14 percent. Alternatively, it may be the case that other countries are unable to absorb their full nominal share. If so, a more relevant indicator may be the market value. The U.S. share of the market value of that capital is about 22 percent. Thus, a rough estimate of the U.S. share lies in the range of 14 percent to 22 percent.

For IMF, the United States' share is based on the amount of gold and currency that it has paid in over the years. Nominally, the U.S. share of the fund's resources and obligations is 17 percent. However, only part of IMF's resources can be used to settle accounts, the usable currencies—the U.S. share of which is about 22 percent. Thus, an estimate of the U.S. share lies between 17 percent and 22 percent.

Changes in Financial Markets Affecting MFIs' Prospects for Loan Losses

The preceding discussion contained estimates of the value of MFI portfolios—in particular, new lending—using market prices for publicly traded bonds and assuming that the debts owed to MFIs are on a level playing field with loans from other lenders. But if the claims of MFIs were senior to the claims of private bondholders, then MFI loans would be less risky. Accordingly, using prices of those sovereign bonds to estimate the value of MFIs' portfolios would underestimate the value of MFI loans because higher seniority would mean that the loans would be paid off first in the event of financial trouble in the borrowing country. Therefore, using market rates would overstate the costs of the subsidies arising from MFI loans.

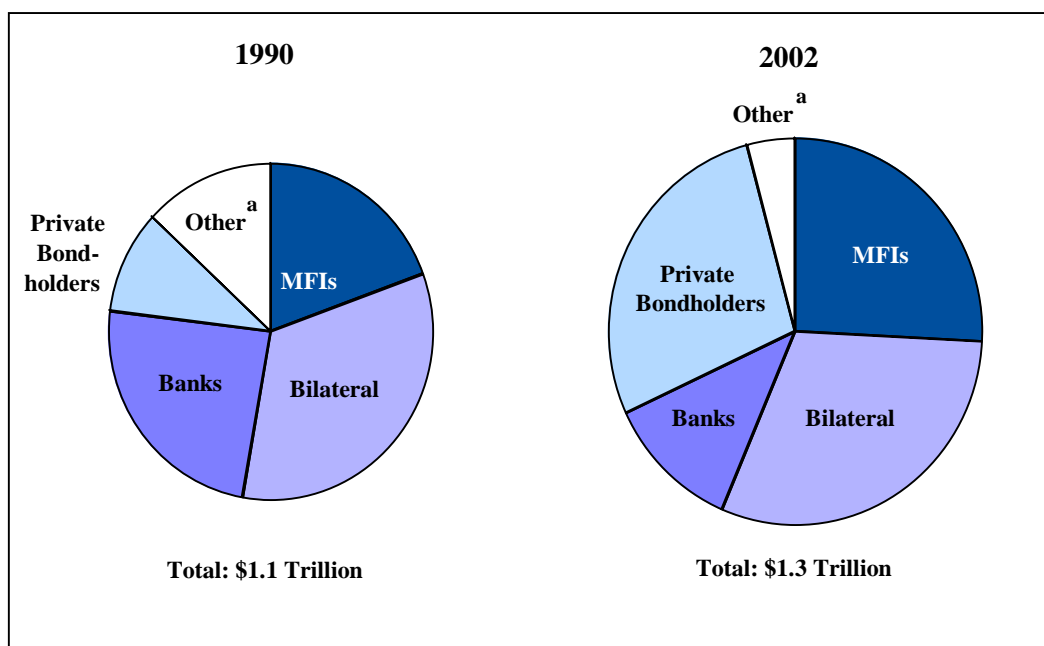
Seniority, particularly the future treatment of new lending, therefore, bears critically on determining the potential future costs of U.S. participation in MFIs. According to both IMF and the World Bank, MFIs do not have seniority established by law or by the provisions of the loan agreements. But even without such legal standing, seniority can arise in practice. Determining such “practical seniority” is complex.

For the past 60 years, most borrowers have fully repaid their debts to MFIs, sometimes even as they were going into arrears, rescheduling, or requesting forgiveness on their debts to other lenders. From that record, one could conclude that the claims of MFIs are not subject to the same risk as the publicly traded bonds of borrowing countries.

However, some of the features of world financial markets that insulated MFIs from defaults in the past may not do so in the future. The effective seniority of MFI loans has been weakened by the reduced importance of bilateral (government-to-government) and commercial bank lending and by the increasing importance of private bondholders. Those changes in the sources of lending have reduced the flexibility of rescheduling debt payments to MFIs.

At the beginning of the 1990s, three groups had made substantial loans to MFI member countries. The MFIs themselves lent nearly exclusively to governments. Other countries, or bilateral lenders, organized for debt-negotiation purposes as the “Paris Club,” provided loans or loan guarantees to borrowing governments. Finally, private international banks, organized for debt-negotiation purposes as the “London Club,” made private loans to governments or to private agents who had guarantees from MFI borrowing members. Each group of lenders accounted for a sizable share of the debts of MFI borrowing members (see Figure 1). As I shall describe, IMF played a key role in coordinating the groups.

Figure 1.
Sources of MFI Borrowers’ Public and Publicly Guaranteed Debts, 1990 and 2003



Source: World Bank, *Global Development Finance Online*.

a. “Other” consists of debts owed to other private creditors.

When a borrowing member of an MFI could not pay all of its loans, it would go to IMF and negotiate a plan for restructuring and rescheduling its debts, usually on the condition of changing its domestic economic policies. Negotiated agreements with IMF set out, among other terms, the maximum total debt repayment that a country would be expected to pay in each year.

The participation of the Paris Club, which would meet to consider debt forgiveness or rescheduling, was often crucial to success. In those negotiations, the Paris Club operated strictly in tandem with IMF. In particular, the Paris Club did not meet to consider rescheduling unless the debtor had negotiated a “program” with IMF.

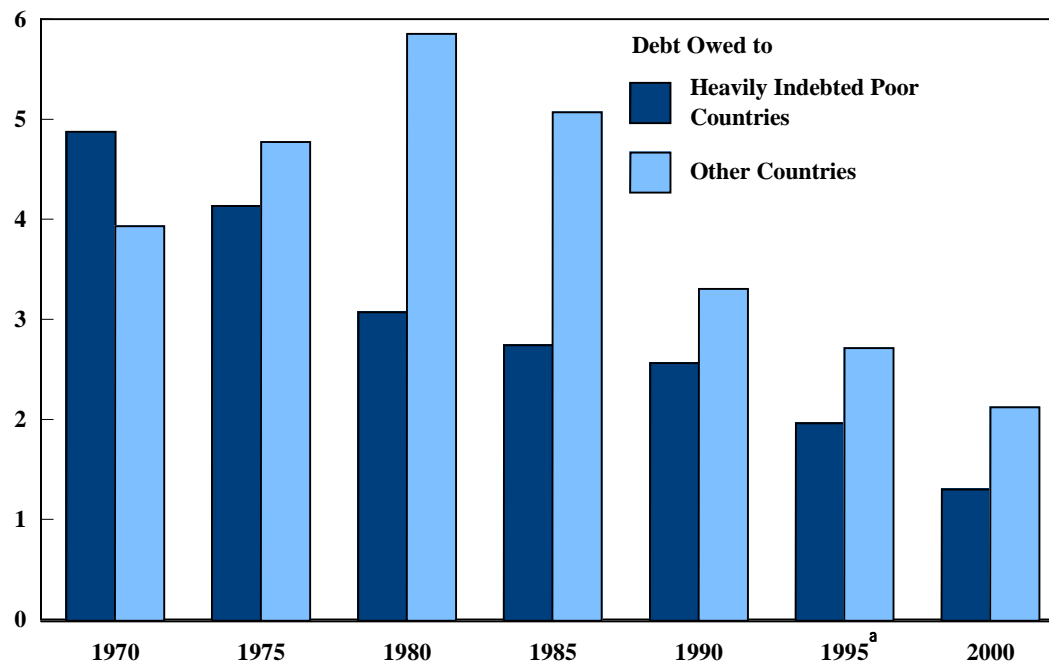
Similarly, according to documentation by the Paris Club, a prerequisite for its own agreements was “burden sharing” with the commercial banks constituting the London Club. Consequently, IMF programs generally included payments to the London Club.

IMF programs provided for rescheduling debts owed to commercial banks and bilateral lenders and did not provide for rescheduling MFI debts; that is, MFIs were paid first. As a practical matter, then, IMF programs gave MFIs seniority over bilateral lenders and private banks.

Historically, the Paris Club’s willingness and ability to make new financial resources available to MFI borrowers through rescheduling has been a key element in establishing MFIs’ practical seniority. For the Paris Club to continue to protect MFIs’ seniority in that way, though, the debts owed to Paris Club creditors must be sufficiently large in relation to the debts owed to MFIs. If the amounts owed to the Paris Club are smaller, rescheduling the debts will be less helpful in permitting the continued servicing of the MFI debts.

MFI lending members have experienced what happens when bilateral debts are not large enough to be rescheduled and, thereby, permit the servicing of MFI loans. For what are termed heavily highly indebted poor countries, bilateral debts had declined steadily relative to the debts owed to MFIs. By 1995, there was only \$2 in bilateral debt per dollar of MFI debt (see Figure 2). Rescheduling Paris Club debts could not provide enough additional resources to permit continuing the timely servicing of the debts owed to MFIs. In the fall of 1996, the World Bank and IMF proposed relief for those countries, which came in the form of additional grants by the United States and other wealthy countries, sales of gold by IMF, and

Figure 2.
Countries' Debt Owed to Bilateral Lenders and Banks
per Dollar of Debt Owed to MFIs
(Dollars)



Source: World Bank, *Global Development Finance Online*.

- a. For heavily indebted poor countries, restructuring debts owed to the bilateral lenders in the Paris Club and to private banks in the London Club stopped working in 1995 as a means of keeping the countries current in their payments. In 1996, lending members of the World Bank and International Monetary Fund began providing them additional resources.

grants from the World Bank (drawing on its retained earnings).⁸ So far, the relief provided to the heavily indebted poor countries has amounted to \$31 billion.⁹

For other countries borrowing from MFIs, too, bilateral and bank debt relative to MFI debt has fallen, from almost \$6 per dollar of MFI debt in 1980 to about \$2 in 2000. Argentina and Brazil, for example, have bilateral debts amounting to less

8. See World Bank, "The HIPC Debt Initiative," available at <http://www.worldbank.org/hipc/about/hipcbr/hipcbr.htm>; and International Monetary Fund, "Debt Relief Under the Heavily Indebted Poor Countries (HIPC) Initiative" (April 2004), available at <http://www.imf.org/external/np/exr/facts/hipc.htm>.

9. International Monetary Fund, "Debt Relief Under the Heavily Indebted Poor Countries (HIPC) Initiative."

than 10 percent of MFI debts, so any rescheduling of bilateral debts would have little relevance in facilitating the repayment of their MFI debts.

A second shift in financial markets that may have diminished MFIs' practical seniority is the increasing importance of private bondholders. In 1990, private bondholders held small amounts of sovereign debt, but in 2002, they held about one-fourth—more than that owed to MFIs (see Figure 1). MFIs do not have legal seniority over private bondholders, and the bondholders are subject to none of the institutional arrangements among the MFIs, the Paris Club, and the London Club that coordinated payments and fostered MFIs' practical seniority in the past.¹⁰

Moreover, as borrowing countries turn more toward lenders in the private sector, during times of distress they may be more willing to continue to service their private-sector debts in order to retain access to those lenders. That shift may further diminish the practical seniority that MFIs have held.¹¹

The legal landscape, too, raises the possibility of diminishing practical seniority for MFIs. In a recent case, a private U.S. creditor did not accept Peru's restructuring of its foreign debt.¹² The creditor obtained a judgment against Peru in the Federal District Court for the Southern District of New York. However, the creditor was unable to attach assets in the United States but then obtained an order from a Brussels court enjoining the Euroclear System from processing Peru's payments on the restructured bonds. The creditor was successful in arguing that Peru could not pay one group of creditors before paying it because of the "pari passu" clause in the bond agreements requiring equal treatment in payments to creditors.

The argument accepted by the Brussels court is currently before the Federal District Court for the Southern District of New York in connection with the debt

10. In 2003, IMF proposed a "sovereign debt restructuring mechanism" (SDRM) that would provide it legal seniority over private bondholders. Those bondholders objected, and the U.S. Treasury did not support the change. Consequently, IMF dropped the proposal for the SDRM.

See International Monetary Fund, *Proposals for a Sovereign Debt Restructuring Mechanism (SDRM): A Factsheet*, available at <http://www.imf.org/external/np/exr/facts/sdrm.htm>; Paul Blustein, "Bankruptcy System for Nations Fails to Draw Support," *Washington Post*, April 2, 2003, available at www.washingtonpost.com; and Anne O. Krueger, First Deputy Managing Director, International Monetary Fund, Address given at the International Monetary Seminar, Banque de France, May 13, 2003, available at <http://www.imf.org/external/np/speeches/2003/051303a.htm>.

11. A U.S. Treasury official recently noted the rising importance of private-sector lending and its potential for further growth. See John B. Taylor, Under Secretary of Treasury for International Affairs, Address given at the IMF conference in honor of Guillermo Calvo, April 16, 2004, available at <http://www.treas.gov/press/releases/js1473.htm>.

12. *Elliott Assocs., L.P., v. Banco de la Nacion*, 194 F.R.D. 116 (S.D.N.Y. 2000).

of Argentina. Concerned about the possibility that the private creditors would be successful in applying the Brussels decision, the Department of Justice submitted a “statement of interest” brief contending that any interpretation of the pari passu clause that would prevent nations from continuing to service their debts owed to MFIs in times of financial crisis was “contrary to U.S. interests.”¹³ The ongoing litigation leaves the future of MFIs’ seniority unresolved.

To What Extent Could Losses by MFIs Accrue to the U.S. Budget?

As operating entities, MFIs have retained earnings, reserves, and precautionary balances that could cover some loan losses. Those resources might postpone calls on the U.S. budget. However, MFIs may not have enough resources to cover all such losses; in fact, to the extent that MFIs’ assets are correctly valued at market prices, the institutions currently have a negative net worth. Moreover, as economic entities, MFIs have no independent source of resources beyond those contributed by their members or any earnings from those contributions that the MFIs retain (which remain the property of their members).

Under IDA’s articles of agreement, no further call on U.S. resources may occur as a result of the association’s activities. Furthermore, because IDA borrowers have been repaying their loans, the association has funds on hand. But the risk revealed by discounts on private-market bond prices and the long terms of the loans at a zero interest rate suggest a high probability of future credit losses, the potential exhaustion of IDA’s capital, and the need for additional resources. In those circumstances, if the Congress followed past practice, it might choose to appropriate additional funds to IDA. However, IDA’s articles of agreement do not compel the United States to honor any of the association’s commitments over and above the money paid in.

IBRD’s articles of agreement provide for no automatic call on U.S. resources as a result of the bank’s activities. In the event that the developing countries borrowing from IBRD did not pay their loans and the defaults exceeded IBRD’s retained earnings, it would have to call for capital to repay the outstanding debts held by its bondholders. Over and above the \$2 billion in capital that the United States has already paid in, the country has agreed to pay in another \$30 billion in callable capital should such an event materialize.¹⁴

13. See David N. Kelley, U.S. Attorney for the Southern District of New York, Statement of Interest of the United States before the United States District Court, Southern District of New York, *Macrotecnic International Corp. v. Republic of Argentina*, 02 CV 5932 (TPG), and *EM, Ltd., v. Republic of Argentina*, 03 CV 2507 (TPG).

14. World Bank, *Annual Report, 2003*, vol. 1, table 11.

In addition to its paid-in capital of about \$11 billion, IBRD has \$26 billion in retained earnings from its previous operations. It could use those funds to cover loan losses before calling for additional capital. Because the U.S. share of IBRD's resources is between 14 percent and 22 percent, the loss of those resources would represent a substantial cost to the United States. If defaults exceeded retained earnings and paid-in capital, IBRD would have to call for capital, including from the United States. The Congress has appropriated about \$7.4 billion for that purpose, so the Treasury could provide up to that amount without additional Congressional action.

IMF, like IDA, has no claim under its articles of agreement to more funds from the United States. Its holdings of gold, amounting to \$41.3 billion, cannot be used to finance its lending operations, but it has been building precautionary balances over the past several years; in 2003, those balances amounted to about \$8.4 billion.¹⁵ Any defaults would reduce the balances but would not automatically lead to a call on U.S. resources.

The Budgetary Treatment of MFIs

The budgetary treatment of the costs associated with MFIs has changed over time and is not uniform among them.

Since 1960, for multilateral development banks (MDBs), including the World Bank and other banks not discussed in this statement, the budget has recorded \$4.6 billion in paid-in capital and \$39.5 billion in direct contributions. The budget reflected those transactions in the traditional manner, as both budget authority and outlays provided to the MDBs.

Over that period, the United States has made about \$62 billion in commitments of callable capital to the MDBs. Before 1981, the Congress appropriated budget authority to the U.S. Treasury to back the commitments. Those appropriations totaled slightly more than \$12 billion through 1980, and all of those funds remain as unspent, unobligated balances at the Treasury. In 1981, the approach of specifically appropriating budget authority for callable capital was dropped. The Congress has continued to provide new limitations on callable capital, bringing the total commitment level since 1960 up to about \$60 billion, with about \$22 billion provided in the 1980s and \$34 billion in the 1990s (only about \$1 billion in callable capital has been provided in the past five years). No budgetary resources have been specifically appropriated to cover those additional commitments.

15. See International Monetary Fund, *Financial Risk in the Fund and the Level of Precautionary Balances*, February 3, 2004, table 4, as of October 2003, available at <http://www.imf.org/external/np/tre/risk/2004/020304.pdf>.

For IMF over the past 40 years, the budget has recorded \$42.4 billion in quota payments and \$9.7 billion in other special-purpose payments. Dating back to the 1967 President's Commission on Budget Concepts, transactions with IMF have been recorded as a means of financing because the United States receives special drawing rights equal to the amounts paid in (and therefore the transaction has been viewed as an exchange of assets of equal value).

However, there are other financial activities associated with the United States' membership in IMF. When the U.S. Treasury sends money to IMF, it gets a reserve position with the fund that forms a portion of the Treasury's monetary assets. IMF pays interest to the Treasury on most of its reserve position. Those interest collections are recorded in the budget as net interest receipts. The amount of interest received by the U.S. government is net of the charges (burden sharing) that IMF levies on creditor countries to cover the estimated risk of IMF loans. In contrast to those earnings, however, the Treasury has realized interest costs because the money on deposit with IMF increases the requirement for the Treasury's borrowing from the public.

As with any foreign exchange asset, the dollar value of the reserve position rises or falls with the exchange rate. Changes in that valuation are recorded in the budget as outlays. If the dollar strengthens, the value of other currencies and thus the reserve position decreases, and that change is recorded as a positive outlay. If the dollar falls in value, the value of the reserve position in dollars increases, and the change is recorded as a negative outlay. Those valuation adjustments are recorded in the budget under the international affairs area.

The current budgetary treatment does not fully reflect the U.S. share of the credit risk associated with the lending and other transactions of MFIs. However, the budget records actual cash flows to and from MFIs, and resources remain in the Treasury to cover a portion (about one-fifth) of the United States' commitments for calls for capital.

When considering how to display in the budget the costs associated with MFIs, three important questions stand out:

- Should the budget record primarily the cash flows to and from MFIs, as it does today, or should it seek to also record and provide resources for potential future risks associated with MFIs' lending and other transactions?
- If the latter, after the funds are first provided, should the estimates of costs be updated and the differences recorded in the budget on a regular (for example, annual) basis?

- Should the budget attempt to record the credit risk associated with the United States' past investment and commitments to MFIs or only the risks associated with the new resources provided?

CBO's work on these issues is not yet complete. The analysis will be more fully developed and subject to CBO's formal review process, which includes review by outside experts. The completed analysis will be presented in a forthcoming paper.

Mr. Chairman, that concludes my statement today. I welcome any questions that you or Members of the Committee may have.