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Institutional Position

The status of the ESF in the US government is comparable to those of a number of other programs for which Congress has delegated substantial authority to the executive but retains oversight responsibility. This chapter reviews the US system of governance, characterized by separate branches with shared powers, and the general pattern of delegation of authority. Within that broader context, the ESF's relationship to the Congress, the Treasury, and the rest of the executive branch and to the Federal Reserve is discussed. The chapter concludes with an examination of the ESF's relationship to the IMF.

Delegation and Accountability

The question of the desirable degree of delegation of congressional authority to the executive is as old as the republic. As the scope of responsibilities of the federal government expanded during the first half of the twentieth century, particularly in the economic and social spheres, Congress granted a great deal of discretion to executive agencies in the interpretation and implementation of legislation. The extent of delegation varied across issue areas and agencies. In some cases Congress kept departments on a relatively tight rein. But in many others, such as the National Labor Relations Board and the Office of Economic Opportunity, Congress gave a great deal of leeway to executive agencies (see, for example, Ripley and Franklin

1987, 14-17). The Supreme Court, with only a few exceptions, sanctioned this broad delegation of authority.[1]

The rationales for delegation in general are several. Complexity and uncertainty place practical limits on Congress's ability to anticipate and legislate for a range of contingencies. Delegation can impart greater flexibility and adaptability to special circumstances than can legislation. Administrative agencies are better equipped with experts to make efficient, nonpolitical policy decisions. Whereas Congress may deliberate at length, the executive can act with dispatch, which is particularly important in the midst of a crisis. Delegation thus also economizes on the time and energy expended by the Congress. In shifting responsibility, delegation might well also shift political costs from the Congress to the executive.[2]

To ensure that delegation is beneficial rather than dysfunctional, legislation that delegates authority should do three things. First, the Congress should clearly specify the purpose of the legislation, to provide a standard by which a court could later determine whether an agency's decision falls within the scope of the law. Second, Congress should provide a clear standard for implementation (Lowi 1979). Third, Congress should review and oversee the implementation of the law, to ensure adherence to its intent. Oversight in turn is of course facilitated by reporting on the part of agencies, which can also be mandated in legislation.

The independence granted to the Federal Reserve System constitutes a special but relevant case of congressional delegation. The constitution gives to Congress the power ''to coin money'' and ''regulate the value thereof'' (article 1, section 8). Since 1914 monetary policy has been conducted by the Federal Reserve. Since the early 1950s the Fed has set monetary policy independently from the administration. Reporting and accountable to the Congress, the Fed accurately describes itself as independent ''within the government'' (Board of Governors of the Federal Reserve System 1984, 2). Such independence keeps monetary policy in the hands of experts who can adopt a long-run perspective and maintain credibility, which reduces the economic cost of fighting inflation. Reducing the opportunity for electoral and partisan manipulation of the economy, these arrangements have generally produced good results since the 1950s.

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1. Delegation is extensively documented and analyzed in the political science literature on congressional-executive relations. See, for example, Woll (1977), Lowi (1979), Fiorina (1982), (1985), Ripley and Franklin (1987), Harris (1964), Dodd and Schott (1979), Kiewiet and McCubbins (1991), and Stillman (1996). Peter Woll (1977, 170), for example, observes: ''It is possible to conclude that there are no constitutional or legal restrictions that have impeded in any substantial way the trend toward greater delegation. This situation has not, of course, resulted from administration usurpation, but from congressional desire. It is a necessary attribute for a modern democratic state.''

2. In this vein, Destler (1995) has argued that the postwar trade policymaking system in the United States provided political protection for Congress for trade liberalization. For a general discussion of the rationales for delegation and a critique, see Fiorina (1982, 1985).

Several factors reconcile this independence with democratic values, argues former Federal Reserve Vice Chairman Alan Blinder (1997), echoing the general literature on congressional delegation cited above. First, the Fed's authority has been specifically delegated by the Congress. We might add that the Fed's independence, while not specified in law, was the subject of an accord with the Truman administration concluded under the watchful eye of the Congress. Second, the Fed's goals, conflicting though they may be, are specified in the legislation governing it. Third, Fed governors are appointed politically. Fourth, the broad grant of power obligates the Fed to a high degree of accountability and a certain degree of transparency (which, Blinder argues, the Fed has observed insufficiently). Finally, the delegation of powers could be revoked in extreme circumstances by an act of Congress. With these principles in mind, Blinder argues that Fed independence could be usefully replicated in other areas of government.

The ESF statute and the conduct of congressional-Treasury relations in the administration of the account over the past several decades—as discussed earlier in chapter 3 and in the remainder of this chapter—clearly fall within the range of common arrangements for the delegation of decision making in other areas of government. The administration of the ESF conforms to the specific principles that confer democratic legitimacy on, for example, the independence of the Federal Reserve. The Treasury Secretary's authority over the administration and use of the ESF was specifically delegated by Congress, under objectives and guidelines enumerated by it, with numerous reporting requirements in place. The Secretary, appointed by the President and confirmed by the Senate, reports and testifies to both. And the authority delegated to the Secretary is retrievable, and in fact it was partially but temporarily retrieved in 1995. Moreover, international monetary and financial policy is an element of general foreign policy, a realm in which the constitution gives the President and executive branch considerably greater powers than in domestic affairs.

Reports, Audits, and Transparency

Treasury disclosure regarding the condition and activities of the ESF was originally quite sparse. Over the decades, however, that has changed a great deal, and it continues to evolve. Now the Congress and the public have a substantial amount of information, released through multiple reports.

The Gold Reserve Act of 1934 required that the Treasury Secretary report only to the President on the activities of the ESF. In the 1939 renewal of the ESF, this requirement was changed, and as of 1940 the Secretary began to report annually to the Congress as well. Those reports were released to the public, first through the annual reports of the Secretary and then, beginning in 1954, through separate reports on the ESF specifically. They include statements on ESF financial operations, the balance sheet, income statements, cash flow statements, and internal audit reports.

Since 1962 the New York Federal Reserve Bank has released a quarterly report on foreign exchange operations that contains a substantial amount of information about the ESF. Published in the *Federal Reserve Bulletin* with a 30-day lag, these reports analyze exchange rate movements, describe underlying economic fundamentals, and disclose the quantities of foreign exchange intervention, if any, over the quarter. They also disclose the amounts of foreign currency held by the Treasury and the Federal Reserve and changes in those positions, marking the value of these holdings to market rates. The reports also include statements on profits and losses on foreign currency operations and the status of currency swap arrangements with foreign authorities. (The report covering April-June 1998 is reproduced in appendix B.) Since the late 1980s, in addition, daily statistics on foreign exchange intervention have been released by the Federal Reserve with a one-year lag. Quarterly balance sheets of the ESF are published in the *Treasury Bulletin* with a six-month lag.

Legislation was passed in 1977 requiring the Secretary to report to the Congress on a monthly basis. Hence, within 30 days after the end of each month, the Treasury provides a "detailed" report to the banking committees of both houses presenting the monthly financial statement and "all agreements made or renewed, all transactions occurring during the month, and all projected liabilities." Under an agreement between the department and these committees, the Treasury simultaneously reports on foreign exchange market operations (including Federal Reserve operations) when such operations have occurred. Both of these monthly reports are confidential. Separately, the Case-Zablocki Act of 1972 (widely known as the Case Act) requires that credit arrangements with foreign governments be transmitted to Congress within 60 days of an agreement. The House International Relations Committee and the Senate Foreign Relations Committee receive these reports. Such credit arrangements are also often notified to the public. In addition, the Treasury has long agreed to provide briefings to interested members of Congress and staff on international financial policy matters.

It is safe to say that the use made of these reports on Capitol Hill is infrequent. Congressional staff might bring the information contained in them to the attention of members of Congress. But, although the reports are available in committee files, most members never ask to see them. On the other hand, the information channel is potentially important in congressional oversight of future operations, and no demonstrable harm has come to US foreign exchange or lending operations from these disclosures to the Congress.

In addition to these reports, the Treasury is also required by Section 3005 of the Omnibus Trade and Competitiveness Act of 1988 to report to the banking committees annually on international economic and exchange rate policy, with an update after six months (see, for example, US Treasury 1999). Notably, the legislation requires the Secretary to appear before the committees to testify on the reports if requested to do so. That request has been made on only a few occasions since these reports were introduced, although the Secretary, Deputy Secretary, and Under Secretary have testified on numerous other occasions.

An annual audit of the ESF is performed by the Inspector General of the Treasury and is included in the annual report of the Secretary on the ESF to the President and Congress (see, for example, US Treasury Department, *ESF Annual Report* 1998). The Gold Reserve Act provided, in language that survives to this day, that the ESF is not only under the exclusive control of the Secretary but also that the Secretary's actions ''are final and may not be reviewed by another officer or employee of the Government.'' The Treasury has used this passage to fend off periodic efforts to have the General Accounting Office perform an audit of the ESF. The GAO has conducted audits of the account's administrative expenses, but these did not extend to the monetary and financial operations of the ESF. The General Accounting Office Act of 1980 authorized the GAO to review activities previously off limits, including the ESF. However, that authority was limited essentially to combating fraud and did not mandate a ''policy audit,'' that is, a review of the full functions of the account. No GAO audit under this authority has been requested.

In the wake of the global financial crisis, the norms for transparency are changing. The severity of the crises in a number of countries might well have been reduced had financial markets had better access to high-quality information on government policies and accounts in emerging-market countries. The Group of Twenty-Two (G-22) thus produced a report on transparency and accountability containing proposals that, if pursued, could substantially change the reporting of information on external financial and monetary operations in general and the ESF in particular. The G-22 working group recommended, for example, that national authorities ''publish timely, accurate and comprehensive information about their foreign exchange liquidity position, including their forward books'' and review the frequency and timeliness of reserve disclosures. The report also recommended that national authorities compile and disseminate information about the ''foreign exchange liquidity position of the public, financial and corporate sectors'' (G-22 1998). The finance ministers and central bank governors of the Group of Seven (G-7) advanced this transparency agenda in October 1998 and February 1999 (G-7 1998, 1999). In this spirit, in February 1999 the Treasury began posting the US reserve position, including foreign currency holdings of the ESF and the Federal Reserve, on a weekly basis with a four-day lag. The G-7, the IMF, and other international organizations committed themselves to considerable further transparency and, as of this writing, were discussing the specific standards of disclosure to which their members would be held.

Budgetary Treatment

The ESF has received no appropriations since its initial capitalization in 1934. Its income—arising from interest receipts from foreign currency-denominated securities, for example, and gains on foreign currency holdings—is plowed back into the capital of the account. The ESF has thus grown substantially over the years without receiving further allocations from the federal budget.

For several decades the ESF was treated wholly off the budget as a public enterprise revolving fund. That changed in 1980, when all such funds were placed on the budget. The budget, however, treats the administrative expenses very differently than it does the operations of the ESF. Expenses are allocated to the Secretary through the budget process as part of the Treasury's annual appropriation. Operations, such as foreign exchange intervention and stabilization loans, remain unappropriated.

Loans (usually in the form of swaps) and intervention are both formally treated as an exchange of short-term monetary assets. These ESF transactions are not recorded as expenditures but rather as a ''means of financing,'' a concept that applies to other credit accounts in the budget as well. Thus, no budget authority is recorded for the ESF. Its net outlays are calculated by netting collections—interest on investments and realized foreign exchange gains—against disbursements—such as payments of charges levied by the IMF on the allocations of SDRs. The net earnings of the account are recorded in the budget and affect the balance for prior years (Penner 1984, reproduced in US House, Committee on Banking, Finance, and Urban Affairs 1984). They are also estimated in the budget for the current year. But these estimates cannot be made reliably and are thus entered into budget documents simply as straight-line extrapolations of previous years' earnings. The income from the ESF has exceeded disbursements in most years and thus the ESF has usually contributed to a small reduction in the federal budget deficit or an increase in the surplus.

In a hypothetical default on a loan made from the ESF, failure to repay principal would require a writing down of the assets of the ESF but would not per se have consequences for the budget. If defaults on principal were large, the ESF would have to reduce the scale of its operations or seek additional capital through an appropriation. A failure to repay interest would affect net budgetary outlays through a reduction in collections (Penner 1984). The Treasury's policy of requiring an assured source of repayment is designed to prevent such defaults from ever occurring.

The ESF played a minor role in the confrontation between the Republican Congress and the Clinton administration over the government shutdown and debt ceiling in late 1995 and early 1996. At that time there was open discussion about the possibility of a US government default on Treasury securities, which Treasury Secretary Rubin sought to prevent. Effective 1 February 1996, he opted not to reinvest the dollar balances of the ESF, along with certain other funds, reducing the debt of the general fund. Because the debt limit is defined in terms of total Treasury borrowing, from other government entities as well as from the public, this action temporarily relieved upward pressure on the ceiling.

The treatment of the ESF is somewhat different from that of US quota payments to the IMF in that quota payments are both authorized and appropriated by Congress in the federal budget. However, like ESF operations, quota payments are exchanges of monetary assets. Cash transfers to the IMF are accompanied by a simultaneous and offsetting receipt, representing the US reserve position in the IMF. Thus, changes in the US quota do not represent net budgetary outlays and do not affect the budget balance. The same is true for credits extended under the General Arrangements to Borrow (GAB) and the New Arrangements to Borrow (NAB). Separately, fluctuations in the exchange rate between the dollar and SDRs give rise to payments to and receipts from the IMF. Although these ''maintenance of value'' transactions are not budgeted for the coming year, because they cannot be projected, they are included in actual budget results for prior years, as is the case with ESF earnings (Wertman 1996).

Warehousing

The Federal Reserve is the Treasury's partner in international monetary and financial policy. To ensure effectiveness when intervening in foreign exchange markets and extending credit arrangements, the Treasury must coordinate its position with the central bank when setting policy. The Fed, after all, controls domestic monetary policy, which greatly influences exchange rates, and has relations with the BIS and many other central banks. The ESF becomes directly involved in the balance sheet of the Fed when it monetizes SDRs (discussed earlier) or when the Fed agrees to ''warehouse'' foreign exchange.

Warehousing is the spot sale of foreign currency to the Fed for dollars along with a parallel repurchase at some specified date in the future. The sale is priced at the prevailing spot rate, and the forward purchase is set at the current three-month forward rate. (In the case of a transaction with a one-year maturity, the agreement would be rolled over at three-month intervals.) When the repurchase agreement matures, the Treasury receives back the foreign currency in exchange for dollars. The maturity date is established at the time of sale, usually less than one year, but the Treasury can unwind the transaction earlier at its option. Neither the Treasury nor the Fed incurs exchange rate risk in warehousing per se. The Treasury remains exposed to valuation gains and losses on warehoused and unwarehoused currency alike.

The practice of warehousing was established in November 1963, as the ESF was being outfitted for more active use. The Federal Open Market Committee (FOMC) originally approved the warehousing of the foreign currency proceeds of borrowing by the Treasury. In 1967 the FOMC severed the link to borrowing, allowing the Treasury to warehouse unborrowed reserves. With warehousing, the Treasury can secure dollars to lend to foreign governments or to sell in the market to support foreign currencies. The Treasury is of course most likely to resort to warehousing when its holdings of foreign currency are high relative to its holdings of dollars.[3]

The Federal Open Market Committee decides on matters related to warehousing and has renewed the arrangement with the Treasury annually since the early 1960s. The FOMC has also adjusted the warehousing ceiling over time. At the inception of the mechanism, the FOMC set the limit at $100 million and raised it to $350 million in November 1967, and to $1 billion in July 1968. The practice of warehousing then lapsed until the late 1970s. When it was revived, the ceiling was raised to $1.5 billion in January 1977, $5.0 billion in December 1978, $10 billion in September 1989, and then $15 billion in March 1990 (figure 8). That limit was reduced to $10 billion in February 1991 and then to $5 billion in February 1992, with the understanding that the FOMC would favorably consider a future Treasury request to raise it again. Indeed, with the onset of the Mexican crisis, the limit was raised to $20 billion in February 1995 (discussed below) and then subsequently reduced to $5 billion.

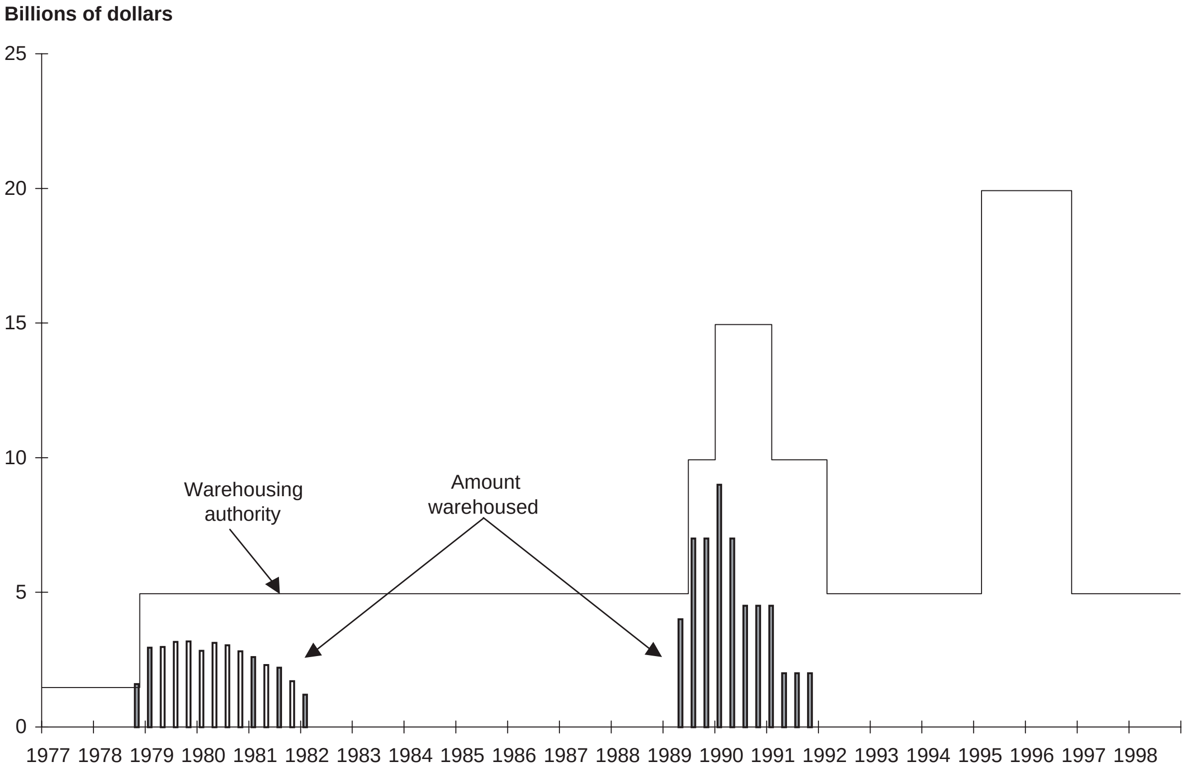
In moving the warehousing ceiling, the FOMC has sometimes engaged in intense internal debates. At the FOMC meeting on 22 August 1989, for example, Vice Chairman Manley Johnson, who differed publicly with the Bush administration Treasury over exchange rate and intervention policy, argued against the increase in the authority (FOMC 1989). In October 1990, Governor Wayne Angell argued that warehousing circumvented the power of Congress to appropriate funds (FOMC 1990).[4] A large majority of FOMC members nonetheless voted to increase the warehousing limits, as they had in response to all other such Treasury requests.

The legal position of the majority is bolstered by several considerations. The General Counsel of the Federal Reserve issued an opinion in the early 1960s articulating the legal basis for the Fed to engage in foreign currency

3. The Treasury could also warehouse foreign currency held in the ESF with the general fund, foreign central banks, the Bank for International Settlements, or conceivably even private banks. For reasons of cost and confidentiality, however, the Treasury prefers the Federal Reserve over the other banks.

4. Some outside analysts have also questioned the legal authority of the Federal Reserve to warehouse. See, for example, Todd (1992).

Figure 8 ESF warehousing with the Federal Reserve, 1977-98



Note: With respect to the amounts warehoused, white bars indicate the author's estimate, while gray bars display reported levels. Bars represent end-of-quarter data.

Sources: US Treasury Department, *ESF Annual Report,* 1977-97; *Federal Reserve Bulletin,* 1977-98; FOMC minutes (various meetings).

operations and warehousing. Congress authorized the Federal Reserve in 1980 to purchase foreign securities, an affirmative action meant to facilitate the Fed's holding of foreign exchange. The counsel opinion, the 1980 law, and 35 years of practice, with disclosures to Congress, would seem to consolidate the legal basis for warehousing (Hackley 1961; Mattingly et al. 1990).

Legal Issues

Over the lifetime of the ESF, several other legal questions have arisen. They deal principally with (1) the exclusivity of control exercised by the Secretary, (2) objectives of the ESF, (3) financial instruments in which it can deal, and (4) the constitutionality of the off-budget nature of ESF operations. The authority of the Treasury to conduct foreign exchange intervention and issue short-term loans from the ESF has never been an issue. However, the scope of the Secretary's discretion, particularly in making medium-term loans, emerged as a prominent legal question in the case of the Mexican rescue of 1995.

There is no court decision or case law that guides legal interpretation of the ESF statute. Legal guidance must be derived from (1) the text of the statute itself, (2) congressional intent as reflected in the legislative history of the statute, and (3) historical practice as it has evolved over 65 years under the oversight of the Congress.

Control

The Secretary's control over the ESF is the least contentious of these questions, because the text of the statute is clear (see paragraph (a)(2) of the current statute, reproduced in box 1). The fact that Congress considered and rejected the proposal to create shared control through a Foreign Exchange Board in 1934 reinforces the exclusivity of secretarial control (US Senate, Committee on Banking and Currency 1934a). The ESF was conceived to operate in secrecy, owing to the nature of foreign exchange markets and the secretive nature of the stabilization funds of foreign governments. This required, as one member of Congress put it in 1934, that ''Congress will have to impose confidence in the honesty and integrity of the Secretary of the Treasury and the President.'' Since then Congress has held a number of hearings and considered several proposals to limit the Secretary's discretion and rejected all of them except for the temporary D'Amato amendment in 1995 (discussed in chapter 6). Similarly, Congress has not limited the ability of the President to invoke the International Emergency Economic Powers Act of 1977 in emergencies even though the range of possible presidential action is broader (Knight 1995b, 10, n.

Box 1 Title 31, United States Code

Sec. 5302. Stabilizing exchange rates and arrangements

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

Proceeds of sales and investments, earnings, and interest shall be paid into the fund and are available to carry out this section. However, the fund is not available to pay administrative expenses.

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

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

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

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

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

12). The Treasury's General Counsel concludes its arguments for secretarial control by saying:

> Given the purpose of the ESF as a means of maintaining order in exchange markets and its genesis as a tool for counteracting similar funds held by other countries, it is entirely reasonable that Congress has vested complete discretion in the Secretary of the Treasury and the President for the operation of the Fund. As the chief financial policy official of the U.S. Government, the Secretary of the Treasury is uniquely situated in the Government to make the complex judgments necessary to determine the need for intervention in currency markets at any particular time. Moreover, as the official primarily responsible for the conduct of the foreign affairs of the United States, the President has the expertise and perspective to

Box 2 Articles of Agreement of the International Monetary Fund

ARTICLE IV

Obligations Regarding Exchange Arrangements

Section 1. *General obligations of members*

Recognizing that the essential purpose of the international monetary system is to provide a framework that facilitates the exchange of goods, services, and capital among countries, and that sustains sound economic growth, and that a principal objective is the continuing development of the orderly underlying conditions that are necessary for financial and economic stability, each member undertakes to collaborate with the Fund and other members to assure orderly exchange arrangements and to promote a stable system of exchange rates. In particular, each member shall:

(i) endeavor to direct its economic and financial policies toward the objective of fostering orderly economic growth with reasonable price stability, with due regard to its circumstances;
(ii) seek to promote stability by fostering orderly underlying economic and financial conditions and a monetary system that does not tend to produce erratic disruptions;
(iii) avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members; and
(iv) follow exchange policies compatible with the undertakings under this Section.

determine whether particular circumstances are unique or sufficiently serious to warrant longer-term efforts at stabilization (Knight 1995b, 10).

Objectives

The Secretary is authorized to ''deal in gold, foreign exchange, and other instruments of credit and securities that the Secretary considers necessary,'' subject to two stipulations. First, the use of the ESF must be ''consistent with the obligations of the Government in the International Monetary Fund on orderly exchange arrangements and a stable system of exchange rates.'' The IMF Articles of Agreement specifically state that members' exchange policies are to be compatible with these objectives. (The relevant portion of the IMF Articles of Agreement is reproduced in full in box 2.) The GAO has concluded, moreover, that the Secretary is solely responsible for determining which uses of the ESF are consistent with IMF purposes (GAO 1996, 116). Second, any ''loan or credit to a foreign entity or government'' made for longer than ''6 months in any 12-month period'' must be accompanied by a presidential certification to Congress that ''unique or emergency circumstances'' require that term (31 USC 5302b).

The objectives of the ESF have evolved over time with changes in the economics and institutions of the international monetary system (see chapter 3). Since 1977 the relevant portion of the statute has read:

> The fund is available to carry out this section, section 18 of the Bretton Woods Agreement Act (22 U.S.C. 286e-3), and section 3 of the Special Drawing Rights Act (22 U.S.C. 286o), and for investing in obligations of the United States Government those amounts in the fund the Secretary of the Treasury, with the approval of the President, decides are not required at the time to carry out this section (31 USC 5302a-1).

The Bretton Woods Agreement Act provides for US membership and participation in the International Monetary Fund and the World Bank. Section 18 states that foreign currency or gold purchased from the IMF may be transferred to and administered by the ESF for use in accordance with its purposes. Repayments may similarly be made from the ESF to the IMF. This provision was inserted in 1962 with the amendment providing for the General Arrangements to Borrow. The cited section of the Special Drawing Rights Act requires that the US share of SDRs allocated by the IMF to its members be credited to the ESF, that foreign currency acquired through exchange for SDRs be deposited in the ESF, and that payments arising from SDR operations be made between the IMF and the ESF.

The Treasury Department acknowledges that ''[a]lthough loans and credits are clearly permitted under the ESF, their purpose must be to maintain orderly exchange arrangements and a stable system of exchange rates, and not to serve as foreign aid.'' With all ESF loans, therefore, ''Treasury has taken steps to assure that there is a source of repayment'' (Knight 1995b, 6). An IMF stabilization program could be such a source; but an IMF agreement is not necessary for the use of the ESF. Identifying a source of repayment is not necessary under the statute but is a matter of Treasury policy.

Medium-Term Loans

As reviewed earlier and summarized in table 1, the Treasury has made numerous short-term loans over the life of the ESF. Whether the Secretary had the authority to make *medium*-term loans, however, was challenged in the case of the Mexican rescue of 1995. Both the term (up to five years) and the magnitude (up to $20 billion) of these loans, after all, were unprecedented. Although the politics and economics of the Mexican operation are deferred until the next chapter, the legal issues are addressed here.

The Clinton administration provided a comprehensive legal defense of the use of the ESF for Mexico in the form of a Justice Department memorandum from acting Assistant Attorney General Walter Dellinger and a Treasury Department memorandum from General Counsel Edward S. Knight (Dellinger 1995; Knight 1995b). The General Accounting Office subsequently concurred with this defense (GAO 1996, 114-17). The counsel opinions argued strongly that Congress has imposed no ''term limits'' on loans from the ESF. In 1977, when the certification requirement was added to the statute for loans with terms exceeding six months, Congress expressed a preference for short-term lending from the ESF but also recognized that in some cases the term might need to be longer. According to the Senate Banking Committee report on the amendments,

> there may be circumstances where longer-term ESF credits may be necessary, and the amendment provides for that possibility. But the committee intends, and the amendment expressly provides, that such longer-term financing be provided only when there are unique and exigent circumstances. As indicated by Treasury, these would include natural disasters, trade embargoes, unforeseen economic developments abroad, political assassinations, or other catastrophic events. In none of these cases should the ESF compete with the IMF, however, and every effort should be made to bring all medium and longer-term financing within the framework of the IMF or other appropriate multi-lateral facilities (US Senate, Committee on Banking, 1976, 11, as quoted in Dellinger 1995, 6, and Knight 1995b, 11).

Members of the Senate Banking Committee considered, yet did not pursue, explicitly restricting ESF loans to the short term. Under Secretary for Monetary Affairs Edwin H. Yeo argued that such restrictions ''would not be appropriate and would unnecessarily impair U.S. flexibility'' (Senate Banking hearings 1976 as quoted in Dellinger 1995, 6). This reasoning, the Clinton administration later pointed out, carried the day.

The committee explained that its preference for short-term lending was based on a concern to avoid undercutting the IMF's policy conditionality (US Senate, Committee on Banking 1976, as quoted in Knight 1995b). However, when ESF loans are made in conjunction with an IMF program, as in the case of Mexico, that concern does not arise.

Also in 1976 Paul A. Volcker, then serving as president of the Federal Reserve Bank of New York, argued that the ESF was intended to be used more flexibly and for a broader range of circumstances than the Federal Reserve swap lines with foreign central banks. The ESF could be used, specifically, for ''longer-term exposure'' than the Fed swap arrangements (US House, Committee on the Budget 1976).

The Clinton administration's use of the ESF for Mexico in 1995 followed the failure in Congress of a large package of loan guarantees that would have been appropriated in the budget. Does that failure suggest that the use of the ESF for Mexico violated the Treasury Secretary's permitted scope of action?[5] The legal answer, which is different from the political

5. Covey (1996, 1132-33) argues that it does.

answer, is clearly no. Congressional debate over the loan guarantees was not brought to a vote, resulted in no legislation, and is not part of the legislative history of the ESF statute. Only deliberations surrounding the original statute and amendments, such as those in 1976 and 1977, provide guidance as to the intent of Congress in the statute. Politically, however, the Clinton administration was forging a path through uncharted territory, as discussed at some length in chapter 6.

Constitutionality

From time to time, questions have been raised about the use of the ESF on constitutional grounds. Article I, section 9, paragraph 7 of the Constitution reads: ''No money shall be drawn from the Treasury, but in consequence of appropriations made by law. . . .'' Senator D'Amato cited this section when he charged in 1995 that the loan to Mexico circumvented Congress's constitutional authority to appropriate funds (*Congressional Record,* 15 August 1995). Representatives Paul, Kucinich, and Sanders made similar arguments when advancing a bill to restrict the Treasury's use of the ESF in July 1998 (*Congressional Record,* 16 July 1998, H5703, H5707, and H5708). Meltzer (1998), Schwartz (1997), and Covey (1996) have also raised constitutional arguments with respect to the loans to Mexico.

The counterarguments are compelling. First, Congress *did* appropriate the original capitalization of the ESF and provided for all income to remain in the account. Second, Congress has enunciated guidelines for the Secretary to apply when using the funds appropriated to the account. Third, the ESF is a revolving fund, and as such is not unique. The federal government operates many funds that, like the ESF, are dedicated to specific purposes, funded by an initial appropriation, and rolled over through cycles of outflows and inflows under congressional guidelines—including trust funds, special funds, and revolving funds. Other revolving funds include, just to name a few, the Postal Service Fund, the Tennessee Valley Authority Fund, and certain accounts of the Export-Import Bank and the Overseas Private Investment Corporation (US Office of Management and Budget 1998a, 321-29). Moreover, the Departments of State, Defense, Energy, and Interior maintain small funds, some initially capitalized by Congress from the proceeds of a fluctuation of the dollar, to cover potential future expenses associated with exchange-rate shifts (see, for example, US Office of Management and Budget 1998b, 249, 284, 392, 555, 666-7). Representative Gonzalez convened the 1990 Banking Committee hearings to determine, among other things, whether the ESF had been used ''to circumvent the appropriations process'' (House, Committee on Banking, 1990). As noted earlier, those hearings produced no changes in the ESF statute.

Relationship to the International Monetary Fund

The US government, and the Treasury Department in particular, operate the ESF and participate in the IMF, and both seek to stabilize the international monetary system and to orchestrate financial rescues when needed. The relationship between the two funds has several components.

First, under US law, the objectives of the ESF are closely tied to those of the IMF. Again, the Treasury's use of the ESF must be "consistent with the obligations of the Government in the International Monetary Fund on orderly exchange arrangements and a stable system of exchange rates."

Second, decision making at the IMF is generally more complex and time consuming than within the Treasury Department. The Treasury thus has a comparative advantage in the quick disbursement of funds and can serve as a "bridge" to IMF funding for countries in financial distress. Indeed, the Treasury often cites a forthcoming IMF loan as an "assured source of repayment" for the ESF.

Third, bridge financing from the ESF in anticipation of an IMF loan can take a special form. Because the IMF maintains a firm policy of not lending into arrears to itself, countries running such arrears face a particular problem, even once they have decided to undertake the policy adjustments necessary for a return to solvency. Under these circumstances, the Treasury will extend a loan from the ESF to the country concerned, which will then repay the IMF, making it eligible for a new IMF loan. On the disbursement of funds from the IMF, the borrower repays the ESF. The Treasury extended a number of such loans as countries were clearing their arrears toward the end of the debt crisis of the 1980s. The duration of these loans has become shorter over time; recently the ESF has been repaid within the same working day (see, for example, table 1, agreement nos. 99 and 106). These arrears-clearing loans, as technical operations designed to overcome a problem arising from IMF policy, are quite distinct from, and should not be confused with, major program credits.

Fourth, when the IMF extends major loans to members, usually through a standby or extended arrangement, the ESF can be tapped not just as a bridge but also as a supplementary source of financing. In this way, the United States can augment the resources available from the IMF and vice versa. The Mexican and Asian crises are cases in point: there were limits on the amounts that each institution could lend, but together the IMF and the bilateral contributions of the United States and other industrialized countries could amass a more credible financial package. Should the IMF ever exhaust its usable resources, pressure to employ the ESF could increase.

Fifth, when making loans in parallel with the IMF, the Treasury benefits from the IMF's policy conditionality. It is of course possible for the Treasury to impose its own policy conditions on the borrower, and it did so in the case of Mexico. But it is useful for US officials to have a multilateral institution in which the borrower is itself a member. US authorities also benefit from having a separate, more technical body with a wealth of country and economic expertise, take primary responsibility—and political heat—for policy conditionality.

Finally, the ESF is the holder on behalf of the United States of SDRs, the reserve asset issued by the IMF. As SDR transactions are conducted and interest payments are made on SDR positions, the balance sheet of the ESF is affected.

Is it desirable to have two separate funds, one operated by the US government and the other by an international body, lending to many of the same countries in crises? This study concludes that it is. The differences between the two funds provide to the United States the benefits of maintaining both unilateral and multilateral instruments. Multilateral institutions, important as they are, should not be the only means of extending international credits. Conversely, the United States would not want to rely on unilateral instruments alone. (These points are discussed further in the concluding chapter.)