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History

The institutional history of the ESF can be usefully divided into three periods: (1) its creation in 1934 through World War II; (2) 1945 through the 1950s, a dormant phase; and (3) 1961 to the present, a period of resurrection, reactivation, and, finally, politicization. This chapter gives particular emphasis, first, to the creation of the account and the legislative history and, second, to the operation of the account in the modern period.

Creation

Shortly after taking office in 1933, the Roosevelt administration took the US dollar off the gold standard and allowed the currency to depreciate substantially against foreign currencies. But in early 1934, administration officials wanted to stabilize exchange rates in order to stabilize domestic prices. President Roosevelt and Treasury Secretary Henry Morgenthau thus sought to codify the suspension of the gold standard, centralize all US gold holdings in the Treasury, halt the flow of gold into and out of the United States, and devalue the dollar against gold from $20.67 to $35.00 per ounce for official purposes. In order to maintain the dollar's external value, the bill they submitted to Congress also provided for the ESF, which was to be funded by an appropriation of $2 billion from the proceeds of the dollar devaluation against gold.

These actions occurred in an international environment ridden with conflict. They followed Britain's jettisoning of the gold standard and depreciating of the pound against the dollar. Administration officials and members of Congress decried the change in the exchange rate as a

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competitive depreciation and vowed to fight fire with fire (see, for example, US House, Committee on Coinage, Weights, and Measures 1934a, 186-87, 201, and *Congressional Record,* House, 20 January 1934, 965-67). The ESF was thus consciously modeled on Britain's Exchange Equalisation Account (EEA), which had been instituted in 1932.

The relevant portion of the proposed act read:

> Sec. 10. (a) For the purpose of stabilizing the exchange value of the dollar, the Secretary of the Treasury, directly or through such agencies as he may designate, is authorized, for the account of the fund established in this section, to deal in gold and foreign exchange, and such other instruments of credit or security as he may deem necessary to carry out the purpose of this section. An annual audit of such fund shall be made and a report thereof submitted to the President.
>
> (b) To enable the Secretary of the Treasury to carry out the provisions of this section there is hereby appropriated out of the receipts which are directed to be covered into the Treasury under section 7 hereof, the sum of $2,000,000,000, which sum when available shall be deposited with the Treasurer of the United States in a ''stabilization fund'' (hereinafter called the ''fund'') under the exclusive control of the Secretary of the Treasury, whose decisions shall be final and not be subject to review by any other officer of the United States. The fund shall be available for expenditure, under the direction of the Secretary of the Treasury and in his discretion, for any purpose in connection with carrying out the provisions of this section, including the investment and reinvestment in direct obligations of the United States of any portions of the fund which the Secretary of the Treasury, with the approval of the President, may from time to time determine are not currently required for stabilizing the exchange value of the dollar. The proceeds of all sales and investments and all earnings and interest accruing under the operations of this section shall be paid into the fund and shall be available for the purposes of the fund (US Senate, Committee on Banking and Currency 1934a, 4-5).

President Roosevelt proposed the bill to Congress on 15 January, and Congress had amended and passed the measure by 30 January.

Several aspects of its legislative history are worthy of elaboration. First, the Republican minority challenged the wisdom of granting the Secretary exclusive control over the new fund. The minority report of the House Committee on Coinage, Weights, and Measures, written by two of the four Republican members, addressed the matter as follows:

> We believe that it is wise and practical to level our most strenuous opposition toward provisions in this bill which we believe are most dangerous and are contrary to traditional American government and are economically unsound. The section which contains such provisions is section 10. . . . This [draft section], in fact, means that the Secretary of the Treasury shall be under no obligation to comply with general laws of the United States in the handling of this fund. . . . We believe that [this section] places autocratic and dictatorial power in the hands of one man directly over the control of the value of money and credit and indirectly over prices. . . . We believe that this is too great a power to place in the hands of any one man. We believe that it is contrary to every true principle of American Government (US House, Committee on Coinage, Weights, and Measures 1934b, 3-5).

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While supporting the creation of the ESF, the minority proposed that it be under the control of a five-person board consisting of the President, the Treasury Secretary, the Governor of the Federal Reserve Board, and two additional members nominated by the President and confirmed by the Senate. They noted that the British EEA was controlled by a three-person board. The Senate Committee on Banking and Currency adopted this suggestion, substituting the Comptroller of the Currency for the President on the board (US Senate, Committee on Banking and Currency 1934b, 1). Although the Foreign Exchange Board did not survive the final act, the clause ''with the approval of the President'' was inserted to qualify the discretion of the Secretary in both paragraph (a) and the first sentence of paragraph (b). The Secretary's control of the new fund, subject only to the President's approval, was thus intensively debated and ultimately accepted by the Congress.

The second major piece of original legislative history concerns the sunset provision. Both the House and Senate committees of jurisdiction inserted a paragraph (c) in section 10 stipulating that the ESF would expire after two years but that the President could extend the life of the fund for one year if he declared that the economic emergency of the country persisted (US House, Committee on Coinage, Weights, and Measures 1934a, 182-83). This provision survived the final act.

Third, the issue of reporting was also discussed. The House inserted a requirement that the Treasury Secretary report on ESF operations not only to the President but to the Congress as well. That provision was dropped by the Senate and in the final legislation. Direct reporting to the Congress, too, was thus expressly rejected during legislative deliberation, although the matter would be revisited on renewal in 1939.

Several important points are notably absent from the hearings, the committee reports, and the *Congressional Record* during the creation of the ESF.[1] First, there is no discussion of the propriety of leaving income and expenses of the ESF and future loans off the federal budget. Second, there is no record of discussion of the terms of loans made by the Secretary from the ESF. The legislative history reveals no assumptions on the part of Congress or the administration that loans would be for short terms only. Third, neither was there any discussion of how the ESF would be liquidated after the two-year period, a particularly curious omission given the insertion of the sunset paragraph.

In the event, the sunset clause was never applied. President Roosevelt renewed the ESF for one year in 1936 by proclamation. Beginning in 1937, Congress renewed the account at two-year intervals until it was made permanent by the Bretton Woods Agreements Act of 1945. During these

1. The congressional documents reviewed were: *Congressional Record,* House, 10, 17, 19, 20, 23, 24, 26, 27, 29 and 30 January 1934; US House Committee on Coinage, Weights, and Measures (1934a); US Senate, Committee on Banking and Currency (1934).

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renewals, several hearings were held and a host of issues raised, including the scope of the Secretary's authority and the nature and disclosure of the ESF's operations. Aside from the renewals, the only important change in the law before 1945 was the introduction of the proposal, rejected in 1934, for direct reporting to the Congress, which began in 1940.

1934-45: Early Operations

The first intervention in the foreign exchange market was conducted on 5 September 1934, supporting the dollar against the French franc. Although the Treasury conducted a number of other interventions during the ESF's first decade (Treasury Annual Reports, cited in Schwartz 1997), the amounts were relatively small. The most significant role played by the ESF in stabilizing exchange rates among major currencies was as the Treasury's main instrument in the Tripartite Monetary Agreement of 1936 with Britain and France (Schwartz 1997; Bloomfield 1944). France had devalued its currency and created its own stabilization fund, completing the joint devaluation against gold (Eichengreen 1992). The 1936 agreement pledged the three stabilization funds to maintenance of the gold value and the gold convertibility of their currencies and thus their exchange rates. The accord committed the funds to maintaining stability technically only on a daily basis, but in practice proved successful in restoring exchange stability on a more lasting basis.

Treasury also entered into several bilateral stabilization agreements that involved extending ESF credit to foreign governments. From its creation until 1945, the ESF opened (and subsequently closed) 12 lines of credit, 4 of which were for Mexico, including the first, which was in January 1936. The others were for China, Brazil, Ecuador, Iceland, and Liberia. However, these credit lines were actually drawn upon in only two cases, Mexico in 1938 and Cuba in 1942, both for a duration of less than one year. Table 1 presents comprehensive data on credit arrangements over the lifetime of the ESF, published here for the first time (see also Schwartz 1996). These transactions were disclosed to and discussed in Congress during the hearings on the renewal of the account (see, for example, US Senate, Committee on Banking and Currency 1939).

1945-60: Early Bretton Woods Regime

During the planning for the international monetary regime to follow World War II, both Harry Dexter White and John Maynard Keynes were influenced by experience with their respective stabilization funds and the Tripartite Monetary Agreement. Various versions of White's plan labeled the proposed multilateral institution the ''United Nations Stabilization

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Fund,'' the ''International Stabilization Fund,'' or simply the ''Stabilization Fund'' (US House, Committee on Banking and Currency 1945, 8; Gardner 1980, 71-77; Dam 1982, 81-83). This was of course changed to the ''International Monetary Fund,'' and the design was modified.

US officials intended that the IMF would provide ''current monetary stabilization operations to afford temporary assistance to members in connection with seasonal, cyclical, and emergency fluctuations in the balance of payments of any member for current transactions'' (Bretton Woods Agreements Act of 1945, section 13a). According to this concept, the IMF would be the primary multilateral defense against disruption of the international monetary system. The Bretton Woods Agreements Act accordingly stipulated that $1.8 billion—which had been held in the form of gold since the inception of the account and not used in foreign exchange operations or credit arrangements—be transferred from the ESF as part of the $2.75 billion quota payment to the IMF[2] (section 7 (a)). Diminished to a small fraction of its original size, the ESF was then made permanent by the elimination of the sunset clause.

The ESF conducted virtually no foreign exchange intervention from 1945 to 1960. The small amounts of foreign exchange holdings were mainly Brazilian and Mexican currencies, in the late 1940s. The Treasury executed its monetary gold transactions through the ESF, the account's principal activity during this period, and concluded additional bilateral stabilization agreements with several Latin American countries. In conjunction with those agreements, the Treasury entered into 13 credit arrangements, mostly with Mexico, of which only 3 or 4 were drawn upon, to ''window-dress'' reserves and supplement IMF loans (see table 1).

The main action in international finance bypassed the ESF as well as the IMF and the World Bank during the early postwar phase. The Anglo-American Financial Agreement and the Marshall Plan were implemented to restore Europe to economic health. The loan to Britain, signed in December 1945, took the form of a US credit in the amount of $3.75 billion authorized by Congress (Gardner 1980, 188-254). Congress authorized the Marshall Plan in April 1948 and appropriated a total of $13 billion over subsequent years. Only once European recovery was secure and current account convertibility restored in Europe in 1958 did the international monetary system and the IMF begin to function more or less as originally envisaged.

Resurrection and Activation

Active management of the ESF dates from the early 1960s. The period since then is divisible into three subperiods defined by the policy challenges of

2. Any future repayment of quota from the IMF would be deposited into the Treasury's general fund as a miscellaneous receipt.

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the decade: (1) defense of the fixed-rate monetary regime during the 1960s, (2) transition to the flexible-rate regime during the 1970s, and (3) dollar fluctuations and debt crisis of the 1980s through the Mexican peso crisis of 1994-95.

Mounting a Defense of the Dollar: The 1960s

The restoration of normalcy in international monetary affairs in the late 1950s coincided with a shift of the US balance of payments toward deficits, by the standard measure of the day, and a drain of gold from the United States under the rules of the regime. The US Treasury therefore adopted a more active strategy to defend the dollar and gold convertibility. That shift in strategy was marked by the first postwar intervention by the United States, in March 1961.

US monetary authorities realized, however, that their financial resources for dollar defense could not support large operations. They therefore cobbled together several sources to finance the effort. First, the Treasury could always draw on its reserve and credit tranches at the IMF. Second, with other leading industrial countries, they created the General Arrangements to Borrow (GAB) in order to supplement IMF resources in the event of a large drawing by the United States and formed the Group of Ten (G-10). Third, and most important in practice, the Federal Reserve opened a series of swap agreements with foreign central banks. Fourth, later in the decade, Special Drawing Rights (SDRs) were created, supplementing international reserves of all IMF member states. The expansion of the ESF thus fit into this larger mosaic of official financial mechanisms and institutions for the defense of the dollar and the fixed-rate regime.[3]

The assets of the ESF, a paltry $330 million at the beginning of this period, were increased in three ways. First, beginning in 1962, the Treasury issued foreign-currency-denominated bonds to foreign monetary authorities (these were called Roosa bonds after the Under Secretary for Monetary Affairs at the time, Robert V. Roosa). Second, in 1963 the practice of ''warehousing'' was instituted, which allowed the Treasury to temporarily convert foreign-currency holdings into dollars at the Federal Reserve. Third, under the Special Drawing Rights Act of 1968, SDR allocations by the IMF were deposited on the books of the ESF. These mechanisms allowed the Treasury to increase ESF assets to $2.6 billion by 1968, $2.1 billion of which was matched by countervailing liabilities. The Federal Reserve, with access to swap lines of much larger magnitude, nonetheless

3. There is an extensive literature on US international monetary policy during this period. See, among other works, Bergsten (1975), Solomon (1977), Odell (1982), Gowa (1983), Pauls (1990), Henning (1994), and Schwartz (1997).

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carried the greater burden of financing dollar support through the end of the Bretton Woods regime (Coombs 1976; Schwartz 1997).

The size of intervention operations over the course of the decade mounted into the billions of dollars. The defense of the dollar included support for the pound sterling, which involved loans to the United Kingdom from the ESF in 1967 and 1968. Separately, the Treasury also extended 20 credit arrangements to Latin American countries and one to the Philippines during the 1960s (see table 1). Because downward pressure on the dollar recurred with some frequency through the beginning of the 1970s, the Treasury preferred to roll over its outstanding Roosa bonds, leaving the ESF exposed to a devaluation of the dollar.

Expansion of the Treasury's international activities during the 1960s presaged the emergence of the issue of the administrative expenses of the ESF. From the inception of the ESF, a portion of its earnings had been used to cover salaries and other operating expenses associated not just with the ESF but with the Treasury's international operations in general. In 1934 those international activities were fairly limited and the associated expenses small. But those activities expanded over the years, and in 1962 the Treasury consolidated them under two new divisions, the Office of Foreign Assets Control and the Office of International Affairs. Both offices were financed by ESF earnings, and neither was subject to external budgetary review.

In 1964 the Treasury used ESF resources to acquire a $150,000 house to be used by the financial attaché stationed in Tokyo. News of this purchase drew fire, prompting a review by the General Accounting Office (GAO) the following year. Although the GAO determined that the Treasury Secretary had the authority to make the purchase, and that the price paid was consistent with housing prices in Tokyo and housing standards for a financial attaché, the report recommended that those of the Treasury's general international activities that were only tenuously related to dollar stabilization "be brought under the traditional congressional appropriation and control process and made subject to the Bureau of the Budget and General Accounting Office scrutiny" (GAO 1965, 2). Congress did not act on the recommendation at that time.

As part of the IMF quota increase that was authorized several years later, in 1970, Congress mandated a GAO audit of the administrative expenses of the ESF. Members clearly intended to limit the scope of the audit to administrative expenses, excluding policy actions and financial operations, and did not wish to "derogate in any way from the broad and absolute discretion of the Secretary of the Treasury and the President provided in section 10 of the Gold Reserve Act of 1934" (US House, Committee on Banking and Currency 1970, 14-15). The GAO submitted its audit report to Congress in 1973 and on that occasion recommended that the Secretary have an "independent assessment" done of the activities

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Table 1 ESF credit arrangements
Part A. 1972-95

			Amount		Description and utilization				
Agreement number	Country	Signing date	Total $ (millions)	ESF $ (millions)	Multi/ bilateral	Repayment source	Backup	First drawn	Fully repaid
115	Argentina[a]	3/28/95	1,000	250	M	IBRD, IDB		5/4/95	12/1/95
114	Mexico[b]	2/21/95	20,000	20,000	B	oil payments	no	3/14/95	1/16/97
113	Mexico	1/2/95	3,000	1,500	B	oil payments	no	1/9/95	1/29/96
112	Mexico Special	8/5/94	11,880	3,000	M		no	not used	expired 12/30/94
111	Mexico	4/26/94	6,000	3,000	B	oil payments	no	1/9/95	1/29/96
110	Macedonia[a]	2/14/94	30	5	M	not applicable	no	not used	expired 2/22/94
109	Mexico	3/24/94	6,000	3,000	B		no	not used	expired 4/26/94
108	Mexico	1/10/94	300	300	B-standing			not used	expired 4/26/94
107	Mexico	11/12/93	6,000	3,000	B		no	not used	expired 3/30/94
106	Peru	3/9/93	900	470	B	IBRD	no	3/18/93	3/18/93
105	Panama	1/29/92	143	143	B	IMF, IBRD	no	1/31/92	3/11/92
104	Mexico	1/12/92	300	300	B-standing			not used	expired 1/12/94
103	Romania	3/6/91	300	40	M	IMF, IBRD	no	3/7/91	3/21/91
102	Honduras	6/28/90	147	82	M	IMF, IBRD	no	6/28/90	11/20/90
101	Guyana	6/20/90	178	32	M	IMF, IDA, CDB	no	6/20/90	9/20/90
100	Hungary	6/19/90	280	20	M	IMF, IBRD	no	6/21/90	9/5/90
99	Costa Rica	5/18/90	28	28	B	IMF	no	5/21/90	5/21/90
98	Mexico	3/23/90	1,300	600	M	IMF, IBRD	oil payments	3/28/90	7/31/90
97	Venezuela	3/16/90	400	104	M	IMF, IBRD	no	3/30/90	4/30/90
96	Mexico	1/12/90	300	300	B-standing			not used	expired 1/12/92
95	Bolivia	12/28/89	75	75	B	IMF	no	12/27/89	1/12/90
94	Poland	12/22/89	500	200	M	IMF	no	12/28/89	2/9/90
93	Bolivia	9/15/89	100	100	B	IMF	no	9/22/89	12/29/89
92	Mexico	9/14/89	200	4,125	M	IMF, IBRD	no	9/25/89	2/15/90
91	Bolivia	7/11/89	100	100	B	IBRD, IDB, bilateral loans	no	7/18/89	9/15/89

90	Venezuela	3/10/89	450	450	B	IMF	no	3/15/89	4/3/89
89	Argentina	10/19/88	500	265	M	IBRD	no	11/22/88	2/28/89
88	Mexico	7/25/88	300	300	B-standing			6/1/88	9/15/88
87	Brazil	7/19/88	500	250	M	IMF	no	7/29/88	8/26/88
86	Yugoslavia	6/10/88	250	50	M	IMF, IBRD	no	6/15/88	7/1/88
85	Argentina	2/23/88	550	550	B	IMF, IBRD	no	2/24/88	5/31/88
84	Mexico	12/31/87	300	300	B-standing			see no. 88	expired 12/31/89
83	Ecuador	12/3/87	31	31	B	IMF, IBRD	no	12/4/87	1/26/88
82	Argentina	10/30/87	675	200	M	IMF, IBRD	no	11/13/87	12/30/87
81	Argentina	3/5/87	500	225	M	IMF	no	3/9/87	7/15/87
80	Nigeria	10/21/86	250	37	M	IMF, IBRD	oil payments	10/31/86	12/11/86
79	Bolivia	9/16/86	100	100	B	IMF	no	not used	expired 11/14/86
78	Mexico	8/26/86	1,600	273	M	IMF, IBRD	oil payments	6/29/86	2/13/87
77	Ecuador	5/14/86	150	150	B	IMF	no	5/16/86	8/14/86
76	Mexico	12/31/85	300	300	B-standing			not used	expired 12/31/87
75	Argentina	6/18/85	483	150	M	IMF	no	6/19/85	9/30/85
74	Argentina	12/6/84	500	500	B	IMF	no	12/28/84	1/15/85
73	Philippines	10/12/84	45	45	B	IMF	no	11/7/84	12/28/84
72	Argentina	3/30/84	300	300	B	IMF	no	not used	expired 9/15/84
71	Mexico	12/31/83	300	300	B-standing			not used	expired 12/31/85
70	Jamaica	12/23/83	50	50	B	IMF	bauxite payments	12/29/83	3/2/84
69	Yugoslavia[a]	4/22/83	500	75	M	Gold, IMF, IBRD	no	not used	expired 11/15/83
68	Brazil	2/28/83	400	400	B	IMF	no	2/28/83	3/11/83
67	Brazil[a]	12/24/82	1,450	500	M	IMF	no	not used	expired 11/30/83
66	Brazil	12/10/82	250	250	B	IMF	no	12/13/82	1/11/83
65	Brazil	11/29/82	450	450	B	IMF	no	11/29/82	3/3/83
64	Brazil	11/17/82	280	280	B	IMF	no	11/18/82	2/1/83
63	Brazil	10/27/82	500	500	B	IMF	no	10/28/82	12/28/82
62	Mexico	8/26/82	1,850	600	M	IMF	oil payments	9/16/82	8/26/83
61	Mexico	8/15/82	1,000	1,000	B	oil payments	no	8/16/82	8/24/82
60	Mexico	12/31/81	300	300	B-standing			not used	expired 12/31/83

(continued)

Table 1 ESF credit arrangements, *continued*
Part A. 1972-95

Agreement number	Country	Signing date	Amount: Total $ (millions)	Amount: ESF $ (millions)	Description and utilization: Multi/ bilateral	Repayment source	Backup	First drawn	Fully repaid
59	Netherlands[c]	8/17/81	500	500	B		no	not used	expired 8/17/91
58	Mexico	12/31/79	300	300	B-standing			not used	expired 12/31/81
57	Mexico	12/31/77	300	300	B-standing				6/30/78
56	BIS[d]	2/1/77	500	500	M			not used	expired 2/7/78
55	Portugal[e]	2/1/77	300	300		IMF	no	2/1/77	9/1/77
54	UK	12/15/76	500	250	M	IMF	no	not used	expired 8/77
53	UK	6/6/76	5,300	1,000	M	IMF	no	6/1/76	12/9/76
52	Mexico	9/20/76	235	235	B			not used	expired 8/25/77
51	Mexico	9/20/76	365	365	B	IMF	no	10/2/76	11/5/76
50	Mexico	9/20/76	300	300	B-standing	IMF	no	11/1/76	4/1/77
49	Mexico	12/31/75	300		B-standing	IMF		not used	expired 12/31/77
48	Mexico	12/31/73	200		B-standing			not used	expired 12/31/75

Part B. 1934-71

Agreement number	Country	Signing date	ESF $ (millions)	Description and utilization
47	Mexico	12/31/71	100	2-year term, not used, expired 12/31/73
46	Mexico	12/31/69	100	2-year term, not used, expired 12/31/71
45	Argentina	5/2/68	75	expired 5/2/69
44	Venezuela	3/18/68	50	expired 3/18/70
43	Nicaragua	3/4/68	5	1-year term, not used, expired 3/4/69
42	Mexico	12/31/67	100	2-year term, no draws by Mexico, ESF drew, expired 12/31/69
41	Argentina	5/2/67	75	1-year term, not used, expired 5/2/68

40	Colombia	4/1/66	13	1-year term, no draws permitted after expiration, total of $10 million drawn and fully repaid by 6/30/69
39	Venezuela	3/18/66	50	2-year term, not used, expired 3/17/68
38	Mexico	1/1/66	75	2-year term, no draws by Mexico, ESF drew, expired 12/31/67
37	Brazil	2/23/65	54	not used, expired 1/12/66
36	Chile	2/4/65	16	$16.1 million drawn, expired 1/30/66
35	Dominican Republic	8/10/64	6	1-year term, $6.25 million drawn, fully repaid by 6/30/67
34	Chile	3/13/64	15	$12 million drawn, repaid by 6/30/67, expired 2/4/67
33	Mexico	1/1/64	75	2-year term, not used, expired 12/31/65
32	Chile	1/31/63	10	1-year term, $12 million drawn, fully repaid by 6/30/66
31	Philippines	5/30/62	25	expired 3/31/63
30	Argentina	6/7/62	50	renewed 3/27/63, $50 million drawn, fully repaid by 10/6/63
29	Costa Rica	9/6/61	6	expired 9/5/62
28	El Salvador	7/14/61	6	expired 7/14/62
27	Brazil	5/16/61	70	2-year term, originally for $70 million, $130 million drawn, fully repaid by 6/30/57
26	Chile	2/10/61	15	2-year term, not used, expired 2/9/63
25	Chile	6/1/59	15	7-month term, not used, expired 12/31/59
24	Argentina	1/1/59	50	1-year term, extended 29 months, $25 million drawn and repaid by 6/30/62, expired 6/7/62
23	Peru	2/17/58	18	expired 2/28/60
22	Mexico	1/1/58	75	2-year term, extended for 2 years twice, expired 12/31/63
21	Nicaragua	10/1/57	5	6-month term, not used, expired 3/31/58
20	Paraguay	8/1/57	6	1-year term, extended 1 year, not used, expired 7/31/59
19	Bolivia	12/14/56	8	1-year term, extended 125 months, not used, expired 2/28/59
18	Chile	4/1/56	10	1-year term, extended 2 years, not used, expired 3/31/59
17	Peru	2/17/54	13	1-year term, extended for 1 year 3 times, not used, expired 2/17/58
16	Mexico	7/1/53	75	30-month term, extended 2 years, not used, expired 12/31/57
15	Mexico	7/1/51	50	2-year term, not used, expired 6/30/53
14	Mexico	6/17/49	12	supplement to previous credit agreement, expired 6/30/51
13	Mexico	7/1/47	50	4-year term, $37 million drawn, repaid in 1950, expired 6/30/51
12	Mexico	7/1/45	40	2-year term, not used, expired 6/30/47
11	Liberia	9/26/42	2	21-month term, not used, expired 6/30/44
10	Brazil	7/6/42	100	5-year term, not used, expired 7/15/47

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Table 1 ESF credit arrangements, *continued*
Part B. 1934-71

Agreement number	Country	Signing date	ESF $ (millions)	Description and utilization
9	Cuba	7/6/42	5	11-month term, 2 extensions totaling 6 years, expired 6/30/49
8	Iceland	5/1/42	2	14-month term, extended for 1 year, not used, expired 6/30/45
7	Ecuador	2/27/42	5	15-month term, twice extended by 1 year, not used, expired 6/30/45
6	Mexico	11/19/41	40	18-month term, extended for 2 years, not used, expired 6/30/45
5	China	4/1/41	50	15-month term, extended for 1 year, not used, expired 6/30/43
4	Mexico	1/6/38	10	1-year term, expired 12/31/38
3	Brazil	7/15/37	60	5-year term, not used, expired 7/15/42
2	China	5/25/36	20	14-month term, not used, expired 7/31/37
1	Mexico	1/3/36	5	2-year term, not used, expired 1/26/38

BIS = Bank for International Settlements; CDB = Caribbean Development Bank; IBRD = International Bank for Reconstruction and Development; IDB = Inter-American Development Bank; IMF = International Monetary Fund

a. A guarantee of Bank for International Settlements (BIS) short-term credit; not called upon.

b. Mexico Medium-Term Exchange Stabilization Agreement (MTSA): Not-to-exceed $20 billion provision covers Exchange Stabilization Agreement (ESA) and Temporary Exchange Stabilization Agreement (TESA) short-term swaps, North American Financial Agreement (NAFA) backing by ESF of Fed short-term swaps, and guarantees.

c. Related to US-Iran claims settlement; renewed biennially until 8/91.

d. Short-term swap facility provided to the BIS in connection with BIS's 2-year credit facility for the United Kingdom under sterling balances arrangement.

e. Portugal drew $85 million through short-term dollar/escudo swaps; remaining $215 million was made available in the form of reciprocal gold deposits, which allowed Portugal to use part of its gold reserves.

Notes: ''Multilateral'' refers to an arrangement that groups other national governments and/or central banks, such as through the BIS. ''Bilateral'' refers to an arrangement that does not include other governments or central banks but could be offered in conjunction with IMF financing.

In addition to the transactions listed here, the Treasury extended an overnight credit on 30 September 1967 and a $200 million line of credit in March 1968 to the United Kingdom, both as part of multilateral operations to support the pound (Solomon 1977, 93-94; Coombs 1976, 172-73).

Source: Adapted from US Treasury Department memorandum, Tim DuLaney to John Lange, ''ESF Credit Arrangements 1936-1995,'' 4 August 1995.

and expenses of the ESF in order to identify those that might be only tangentially related to dollar stabilization. The GAO also recommended transferring responsibility for the annual internal audit within the Treasury from the office that operated the ESF to that which audited the department itself, a measure implemented by Secretary of the Treasury George P. Shultz (US Treasury Department, *ESF Annual Report* 1973, 6-7).

Adapting to the Flexible-Rate Regime: The 1970s

The demise of the Bretton Woods regime and the switch to flexible exchange rates in the early 1970s transformed the environment in which the ESF operated. The suspension of gold convertibility of the dollar in August 1971 put to rest Treasury and Federal Reserve fears about a further gold drain. The introduction of flexible rates relieved US monetary authorities of the obligation to intervene to defend the dollar and the necessity of borrowing from foreign governments to support that effort (or lending to them to support their currencies). American officials nonetheless chose to maintain a capacity for such intervention and sometimes used it to limit fluctuations in the dollar under the new regime.

The ESF's statutory purpose of stabilizing the exchange value of the dollar was not rendered moot by the switch to flexible rates. After all, the Gold Reserve Act was originally passed under somewhat similar circumstances—that is, just after the United States had jettisoned the gold standard, experienced a depreciation of the dollar, and switched to a flexible-rate regime vis-à-vis the pound sterling and other currencies. But the passing of the Bretton Woods regime nonetheless forced a reexamination of that objective. The codification of the new regime, with the Second Amendment of the Articles of Agreement of the IMF,[4] provided an opportunity to amend the statute.

Under the Gold Reserve Act as amended in 1976, therefore, the Secretary was to use the ESF in a manner ''consistent with the obligations of the Government in the International Monetary Fund'' (31 USC 5302b). Coupled with the Treasury's desire to limit extreme fluctuations of the dollar at times, this mandate confirmed a continuing purpose for the ESF. Congress, however, wishing to prevent any conflict with the purposes of the IMF, explicitly limited loan terms to six months or less unless ''unique or emergency circumstances'' obtained and the President provided written notice to that effect (US Senate, Committee on Banking, Housing, and Urban Affairs 1976, 11).

During Congress's review of the Second Amendment, members also raised concerns about the weakness of legislative oversight of the use of the ESF. To allay these concerns, Treasury Secretary William E. Simon

4. The first amendment provided for the creation and issuance of SDRs.

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agreed to send to the Congress on a monthly basis a report on ESF transactions, including a balance sheet. Those reports were to go to the banking committees of both houses. The Simon Treasury also agreed to provide briefings to interested members of Congress and staff on a quarterly basis, among other measures to bolster congressional oversight (US Senate, Committee on Banking, Housing, and Urban Affairs 1976).

At this time, nothing was done to wrest authority over the administrative expenses of the ESF from the Treasury. The department continued to interpret its authority broadly in the use of the account, and continued to fund personnel and travel. By the mid-1970s these expenses, which included the salaries for the roughly 250 people in the international division of the Treasury, amounted to approximately $15 million annually (figure 3). Some of the expenses of other agencies that were related to international monetary or financial policy were also paid from the ESF (Corwin 1995).

Stories of infractions in the use of the account continued to circulate. The purchase of the financial attaché's residence in Tokyo was mentioned earlier. Secretary David M. Kennedy reportedly drew on the ESF to purchase an oriental carpet for $8,000.[5] Post-Watergate Washington, moreover, was increasingly intolerant of "slush funds." The Budget Reform Act of 1974 in particular was designed to rationalize federal budgeting and place many off-budget transactions on the budget. But the 1974 Act did not revise the budgetary treatment of the ESF.

After Jimmy Carter was elected President in November 1976, but before the Ford administration departed, Secretary Simon embarked on a trip to London, Moscow, and Mexico City with a retinue of 42 people and no identifiable official purpose. The cost of the trip, $131,500, was covered by the ESF. The *Washington Post* portrayed the junket as particularly hypocritical, recalling Simon's own description of the federal food stamp program as a "haven for chiselers and rip-off artists" (*Washington Post*, 27 November 1976, A1 and A14).

Hence when the Carter administration came to office, members of Congress pressed Treasury Secretary W. Michael Blumenthal and his officials to place the ESF in its entirety on the budget. The new Treasury balked, for several reasons. First, subjecting ESF operations to congressional appropriations would eliminate flexibility, confidentiality, and speed in the deployment of the account. Second, the account was weak financially, and incoming Treasury officials were concerned that disclosing this fact to the markets would weaken the effectiveness of their policies on exchange rates and international finance. The foreign currency liabilities of the fixed-rate period—mainly rolled-over Roosa bonds—had created

5. Shortly after the Carter administration took office, Under Secretary Anthony Solomon ordered that the carpet be sold at auction, which was done at a small profit to the ESF.

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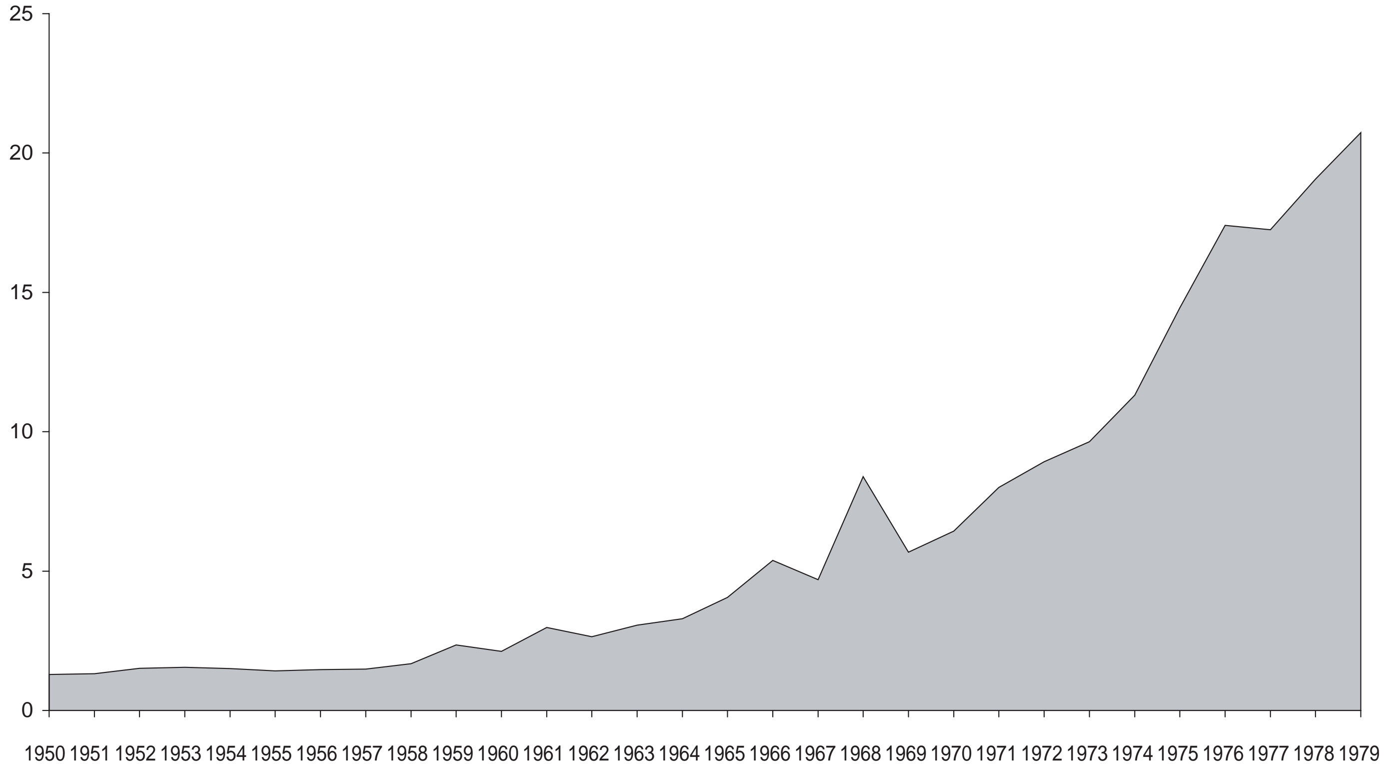
Figure 3 Administrative expenses of the ESF, FY1950-79



Sources: US Treasury Department, *Annual Report of the Secretary of the Treasury* (1950-53); *ESF Annual Report* (1954-79).

(realized and unrealized) losses for the ESF as the dollar depreciated.[6] Owing to these losses, the ESF would soon technically register a *negative* capital position (figure 4). Scoring SDRs as equity would have improved the reported capital position and been somewhat more realistic, but doing so would have departed from formal accounting practices and have involved complex explanation. (An analysis of the balance sheet and financial performance of the ESF is provided in chapter 4.)

Under Secretary for Monetary Affairs Anthony M. Solomon and Assistant Secretary for International Affairs C. Fred Bergsten proposed placing only the administrative expenses, rather than the entire account, on budget. The Blumenthal Treasury also reaffirmed the Simon Treasury's commitment to closer consultations and regular briefings of interested members of Congress and congressional staff. Congress accepted this compromise (US Senate, Committee on Banking, Housing, and Urban Affairs 1977), and the administrative expenses were placed on budget for the first time in FY1980. The change in budgetary treatment proved to be important, though the realization of its significance was delayed. No one in the 1970s appears to have anticipated that Congress would use the appropriations process not simply to prevent budgetary abuses but also to constrain the Treasury's use of the ESF as a matter of policy, as transpired in the 1990s.

When the dollar reached record lows against the German mark and the Japanese yen at the end of October 1978, the Treasury and the Federal Reserve mounted a rescue operation in cooperation with foreign monetary authorities (Putnam and Henning 1989; Cohen and Meltzer 1982). The total package, publicized as $30 billion, included the issuance by the Treasury of two- and four-year bonds in the private German and Swiss capital markets. The proceeds from these ''Carter bonds,'' amounting to the equivalent of $4.15 billion, were available to the ESF for intervention. Like the Roosa bonds, these bonds were issued by the Bureau of Public Debt. Unlike the Roosa bonds, the general fund, not the ESF, held the foreign exchange exposure. Because the dollar rose in subsequent years, the Carter bonds earned a substantial profit for the general fund when they were fully retired by July 1983.

In 1979 and 1980 the Treasury Department intervened in the foreign currency markets fairly frequently, using appreciations of the dollar as opportunities to buy foreign exchange (see figure 1). These operations served the purpose of stabilizing the dollar, raising the foreign currency with which to redeem bond debt, and building a ''war chest,'' as Under

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6. In early 1977 the Treasury had sustained losses on Swiss franc-denominated bonds of at least $278.6 million and expected to lose at least several hundred million dollars more. When these issues were retired in 1979, total losses since 1961 amounted to $1,134.6 million. (Calculated by the author from information provided in US Treasury Department, *ESF Annual Reports* 1977, 10-13, and 1979, 7.)

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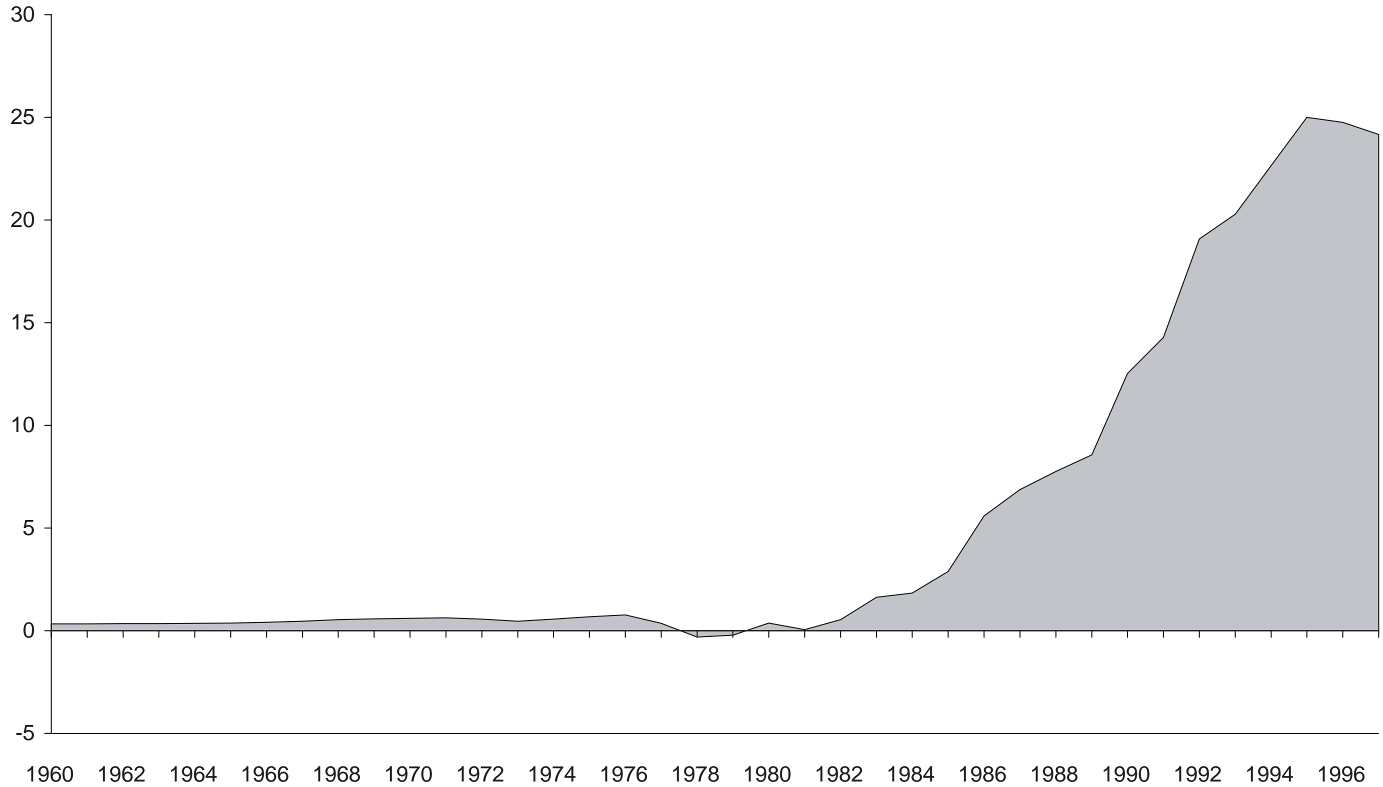
Figure 4 Capital position of the ESF, FY1960-97

Billions of dollars



Source: US Treasury Department, *ESF Annual Report* (1960-97).

Secretary Solomon described it, for the future. Previously, the ESF had never held a substantial long-term net reserve position, that is, a stock of foreign currencies that Treasury did not owe principally to European central banks. The Carter administration Treasury sought to eliminate this dependence on foreign monetary authorities, which was particularly important given its judgment that the dollar's strength could be temporary. Between October 1979 and mid-February 1981, the Treasury and the Federal Reserve purchased roughly $7 billion in foreign currencies, mostly German marks, building a combined net position of $6 billion equivalent, compared with a net liability position of $3.5 billion in September 1979 (Pauls 1990, 903-04).

Dollar Fluctuations and the Debt Crisis: The 1980s and Early 1990s

The advent of the Reagan administration brought a fundamental change in exchange rate policy. The new Under Secretary for Monetary Affairs, Beryl Sprinkel, announced the suspension of foreign exchange intervention except in extreme circumstances, for which only a handful of instances qualified over the following four years. The Treasury transferred $345.5 million worth of German marks and Japanese yen, plus $691 million equivalent of SDRs, to the general fund to finance part of the reserve asset portion of the increase in the US quota in the IMF (US Treasury Department, *ESF Annual Report* 1984, 3). Foreign exchange reserves thus declined, partially reversing the Carter administration's effort to build a war chest.

The third world debt crisis that began in 1982, however, created a new need for ESF financing. The IMF became the focal point for organizing packages of loans, conditionality, and rescheduling. The ESF and other official mechanisms such as central bank swaps and the Bank for International Settlements (BIS) were often needed to supply bridge financing. These loans were backed by the receipts of the borrower from the IMF, when its agreement with the IMF was finalized and funds disbursed. Although the Treasury theoretically accepted the risk that an agreement between the borrower and the IMF would fall through, bridge and IMF financing were treated as a package in negotiations in which the Treasury had been a central player, could influence the terms, and could be satisfied that essential conditions had been met before making any disbursement from the ESF. The ESF was in fact repaid in every case. Over the course of the 1980s, Treasury offered 37 such bridge loans to debtor countries, again mostly in Latin America (see table 1). Such operations continued into the early 1990s.

Notably, one of the loans made to Mexico in 1982 was extended beyond six months, almost to one year (agreement no. 62, table 1). As required by the changes made in the law in 1977, President Reagan certified at the time that extraordinary circumstances required the longer term.

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The ESF's bridging role attracted the attention of those members of Congress who were critical of the Treasury's policy in the debt crisis in general. The authority of the Secretary and the purposes of the ESF were once again discussed in congressional hearings, specifically in connection to the 1984 loan to Argentina, but no change in legislation resulted from this review (US House, Committee on Banking, Subcommittee on Banking, Finance, and Urban Affairs 1984).

ESF loans next became an issue as the Eastern bloc was collapsing at the end of the 1980s. In the case of Eastern European countries, however, the roles of Congress and of the executive were reversed. Rather than serving to check lending by the Treasury, members of Congress pressed the Department to lend to Poland in 1989 on a longer-term basis and argued that the Secretary had the authority to do so from the ESF. Treasury officials argued that, as a matter of policy, owing to the absence at that time of an assured source of repayment, assistance to Poland should instead be appropriated by Congress (US House, Committee on Foreign Affairs, 1989, 148-49, 161-71). Once progress had been achieved on an IMF program, however, Treasury officials agreed to use the ESF as a short-term bridge at the end of the year (table 1, no. 94). They maintain that the Treasury's original stance on Poland in 1989 does not prejudice its legal authority to make longer-term loans (Knight 1995b, 6, n. 7; US House, Committee on International Relations 1995b, 27; discussed further below).

Separately, beginning with the Plaza accord of September 1985, Treasury Secretary James A. Baker III reversed the Treasury's position on foreign exchange intervention. US authorities aimed first to drive the dollar downward from its extraordinary heights of 1985 and then, beginning in 1987, to stabilize it. As had become customary since the 1970s, the Treasury and the Federal Reserve shared the financing of these interventions. When the Bush administration initiated unprecedentedly large purchases of German marks and Japanese yen in 1989 and 1990, however, most of the members of the Federal Open Market Committee (FOMC) objected to the policy of limiting the appreciation of the dollar, and three of them voted against raising the limit on warehousing the ESF's foreign currency holdings from $10 billion to $15 billion. The public FOMC record, which tends to give disproportionate emphasis to minority views, reported the dissidents' suggestion at the March 1990 meeting that warehousing "could be viewed as avoiding the congressional appropriations process called for under the Constitution" (FOMC 1990).

The Federal Reserve's dispute with the Treasury caught the attention of the chairman of the House Banking Committee, Henry B. Gonzalez (D-TX), who convened a hearing on the use of the ESF for intervention and financing for debtor countries. Opening the hearings, Gonzalez criticized the ESF as "back-door financing," quoted the previous passage

from the FOMC record, and argued that there was ''a complete lack of public accountability.'' The GAO proposed that its auditing authority be broadened from the administrative expenses to a more thorough policy review (US House, Committee on Banking 1990). These concerns were apparently not broadly shared within the Congress, however, and there was no change in the ESF law, in related statutes, or in the auditing authority of the GAO. As political issues, the scope of authority and the accountability of the Secretary in using the ESF dissipated and remained dormant until the Mexican peso crisis of 1994-95 (discussed in chapter 6).

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