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Introduction

The financial crisis that began in Asia in the spring of 1997 and later spread to Russia and Latin America spawned a series of financial rescues on the part of the international community. Although the International Monetary Fund (IMF) led the rescues, the contributions of national governments have been important to the credibility and the success of the stabilization programs of stricken countries. The Exchange Stabilization Fund (ESF) is the principal mechanism through which the United States contributes to such rescue packages.

The Congress and the Franklin D. Roosevelt administration created the ESF through the Gold Reserve Act of 1934. The basic purpose of the account was and remains the stabilization of exchange rates and the international monetary system. Congress delegated the management of the ESF to the Secretary of the Treasury and oversees the activities of the executive branch in these matters. The Department of the Treasury has used the ESF primarily for foreign exchange intervention and secondarily, though importantly, for stabilization loans. Congress also provided that all income and profits from the ESF's investments and operations remain part of the account, and its assets have grown over the decades to about $40 billion today.

Having labored in relative obscurity for most of its existence, the account was thrust into the spotlight—as well as intense political controversy—by the Mexican peso crisis of 1994-95. In January 1995 the Clinton administration asked Congress to approve an assistance package consisting of $40 billion in loan guarantees for the Mexican government. The new 104th Congress balked, however, and the administration resorted to extending a $20 billion line of credit to Mexico from the ESF.

Upon learning that the Clinton administration had resorted to using the ESF in the face of congressional opposition to the loan guarantees, several members of Congress and outside observers charged that the will of the national legislature was being circumvented.[1] The amount and the term of the loan to Mexico were indeed unprecedented in the history of the ESF. Treasury Secretary Robert E. Rubin argued in response that assistance to Mexico was in the US interest, that a rapid response to the peso crisis was necessary, and that the Gold Reserve Act gave him sole discretion over the use of those funds.

Although correct legally as well as economically, Secretary Rubin's decision sparked a vigorous debate on the authority of his office and the scope of the ESF's functions. Congress placed restrictions on the use of the ESF for two years beginning in October 1995. More recently, the global financial crisis has rekindled the debate. In July 1998 the House of Representatives narrowly rejected a bill proposed by Representatives Spencer Bachus (R-AL) and Bernard Sanders (I-VT) that would have prevented the Treasury from tapping the ESF for any significant international loan. Among academic commentators, the debate has extended beyond the use of the ESF for international financial rescues to the question of whether it should be liquidated altogether[2]—which would of course halt the Treasury's conduct of foreign exchange intervention.

Additional questions raised in the debate include: Has the ESF been used in a *stabilizing*, welfare-enhancing fashion in the past? Should the ESF be making *medium-term loans* to foreign governments suffering external financial crises? Should the Secretary of the Treasury have exclusive *control* over the disposition of ESF funds? How should congressional *oversight* be administered? How should executive branch *accountability* be preserved?

The purpose of this study is to inform the debate on the role and purposes of the ESF and to provide recommendations on how its activities can best be organized institutionally within the US government. A central question of this study is: *How can the United States maintain democratic accountability for executive branch officials engaged in international financial rescues and at the same time preserve a capacity to respond to financial crises with speed, flexibility, and effectiveness?* The study examines the history, legal bases, and financial operations of the ESF, with particular attention to the relationship between Congress and the executive branch.

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1. Those critics in Congress included Senators Alfonse D'Amato (R-NY) and Jesse Helms (R-NC) and Representatives John Boehner (R-OH), Bob Barr (R-GA), Helen Chenoweth (R-ID), Peter DeFazio (D-OR), Marcy Kaptur (D-OH), Joe Scarborough (R-FL), Steve Stockman (R-TX), and Gene Taylor (R-MS). See *Washington Times,* 2 and 7 February 1995; *Financial Times,* 24 February 1995; and *Congressional Record,* 2 February 1995, S1975.

2. See, for example, the comments of Lawrence B. Lindsey and Allan H. Meltzer before the US Congress Joint Economic Committee (1998, 66-67) as well as Schwartz (1998a), Calomiris (1998), and Schwartz, Whalen, and Todd (1998).

The study concludes that, because foreign exchange and international financial markets are imperfect, the United States should maintain the ESF. The Secretary of the Treasury should retain sole authority and wide latitude in the use of the account. Congress should resist any impulse to constrain the Secretary's authority over or access to the ESF. However, the Secretary should also continue to manage the account conservatively, by observing several basic principles of emergency finance, and should increase the transparency of the ESF, an area in which progress is currently being made. Congress should maintain consistent oversight of the Secretary's administration of the ESF, a process facilitated by thorough reporting by the Treasury on the account. These conclusions contrast sharply with the recommendations of many critics of the ESF.

The study contributes to a larger set of analyses related to the global financial crisis and, as Secretary Rubin has dubbed it, the ''international financial architecture.'' Debates are under way within policy and academic circles over the causes of the crisis, the stability of financial markets, the role of exchange rate policy, the contribution of moral hazard, the roles for international financial institutions, and the need for an international lender of last resort and other possible remedies. I believe that the willingness of governments to maintain open capital regimes in the long run depends on the availability of mechanisms to cushion them from financial shocks and that there is a positive role for governments and international financial institutions in this regard. This broader array of issues is not addressed in detail here, however; this study leaves to other studies the problem of designing international mechanisms to stabilize the financial system, to minimize moral hazard, and to ''bail in'' private financial institutions.[3]

Chapter 2 provides a basic overview of and rationale for the ESF. Chapter 3 presents a brief history of the account from its creation in 1934 through the early 1990s. Chapter 4 assesses the financial performance of the ESF and profiles its balance sheet. Chapter 5 addresses the institutional status of the account vis-à-vis the executive branch, Congress, and the Federal Reserve (under the headings of delegation, transparency, budgetary treatment, ''warehousing,'' and legal issues) as well as the IMF. Chapter 6 presents the political history of the Clinton administration's response to the Mexican peso crisis and the reaction of the Congress. Chapter 7 describes the unfolding of the global currency and financial crisis and how the legacy of Mexico shaded the US response. The study concludes with a review of the major findings and a set of recommendations on the Treasury's latitude in the use of the ESF and on how the executive and Congress should relate to one another on these matters.

3. See, for example, Group of Twenty-Two (1998), Eichengreen (1999), and Fischer (1999).