Frequently Asked Questions about IMF Involvement in the Eurozone Debt Crisis

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Summary

On May 2, 2010, the Eurozone member states and the International Monetary Fund (IMF) announced an unprecedented €110 billion (about $145 billion) financial assistance package for Greece. The following week, on May 9, 2010, EU leaders announced that they would make an additional €500 billion (about $636 billion) in financial assistance available to vulnerable European countries, and suggested that the IMF could contribute up to an additional €220 billion to €250 billion (about $280 billion to $318 billion). This report answers frequently asked questions about IMF involvement in the Eurozone debt crisis.

For more information on the Greek debt crisis, see CRS Report R41167, *Greece's Debt Crisis: Overview, Policy Responses, and Implications*, coordinated by (name redacted).

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Background on the Eurozone and the IMF

What is the Eurozone?

The Eurozone refers to the group of European Union (EU) countries that use the euro (€) as their national currency. The euro was introduced in 1999 as an accounting currency and in 2002 as physical currency in circulation. The Eurozone originally included 11 countries and has since expanded to 16 countries. Greece joined the Eurozone in 2000. Currently, the countries in the Eurozone include Austria, Belgium, Cyprus, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia, and Spain.

The EU has 27 member states. Denmark, Sweden, and the United Kingdom are members of the EU that have opted out of joining the Eurozone. All recent entrants to the EU, including Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, and Romania, are required to adopt the euro as their national currency as soon as possible, but must meet certain economic policy targets before they are eligible. Budgetary discipline is one of the criteria for joining the euro. Under the Treaty on European Union, commonly referred to as the Maastricht Treaty, EU member states are required to stay below a government budget deficit ceiling of 3% of GDP and external debt ceiling of 60% of GDP. Enforcement by EU authorities has been weak, however, and many governments have exceeded these ceilings. When the euro was introduced, some raised concerns about the viability of an economic union that has a common monetary policy but diverse national fiscal policies.

What is the IMF?

The International Monetary Fund (IMF) is an international financial institution that was created after World War II to promote exchange rate and monetary stability. The founders aimed to avoid the beggar-thy-neighbor exchange rate policies and banking instability that deepened the Depression during the 1930s and the lack of any international mechanism for setting standards or coordinating policy. The IMF has changed over time as the world financial system has evolved. It now provides more technical assistance to member countries on banking and finance issues. However, its principal function is still one of lending money and encouraging reform to help countries deal with balance-of-payments and financial crises. The main concern is the possible contagion effects that might bring down other countries if a crisis in a specific country is not addressed.

The IMF is owned by its member countries, whose votes are proportional to the amount of money they have subscribed to help fund its operations. The IMF funds its own internal budget from income earned through its lending program. The disbursements for IMF loans are generally conditional on the borrower country implementing reforms. Loans are generally disbursed in phases ("tranches") in order to encourage compliance with loan conditions. If conditions are not met, funds are not disbursed. The IMF charges its borrowers a rate of interest roughly equivalent to the price that major governments around the world pay to borrow funds, and it pays its member countries interest when it uses their quota resources to fund its loans. Disbursements for its regular loans, called Stand-By Arrangements (SBA), are repayable in five to eight years. Repayments for some of the IMF's more specialized programs may occur over a longer period of time. Until the mid-1970s, developed countries were frequent borrowers from the IMF. Since

then, developing countries (particularly emerging markets) have been the principal borrowers. However, during the recent financial crisis, the IMF lent substantially to several of the newer members of the European Union (EU), and it has also assisted countries with advanced economies from time to time.

Eurozone/IMF Financial Assistance Package for Greece

Why did Greece turn to the other Eurozone member states and the IMF for financial assistance?

Over the past decade, Greece borrowed heavily in international capital markets to fund government budget and trade deficits. High government spending, weak revenue collection, structural rigidities, and loss of competitiveness are typically cited as major factors behind Greece's accumulation of debt. Access to capital at low interest rates after adopting the euro and weak enforcement of EU rules concerning debt and deficit ceilings may also have played a role.

Reliance on financing from international capital markets left Greece highly vulnerable to shifts in investor confidence. Investors became increasingly nervous in October 2009, when the newly elected Greek government nearly doubled the government 2009 budget deficit estimate. Over the next months, the government announced several austerity packages and had successful rounds of bond sales on international capital markets to raise needed funds. In late April 2010, when the European Union's (EU's) statistical agency, Eurostat, further revised the estimate of Greece's 2009 deficit upwards, Greek bond spreads spiked and two major credit rating agencies downgraded Greek bonds. Greece's debt crisis threatened to spread to other European countries, including Ireland, Italy, Portugal, and Spain, that may face fiscal challenges similar to Greece.

The Greek government formally requested financial assistance from the 16 countries that use the euro as their national currency (the Eurozone) and the IMF on April 23, 2010. It was hoped that the financial assistance, combined with austerity measures, would prevent the Greek government from restructuring or defaulting on its debt or, more dramatically, from abandoning the euro in favor of a national currency.

What financial assistance is being provided to Greece?

On May 2, 2010, the Eurozone member states and the IMF announced a three-year, €110 billion (about $145 billion) financial assistance package for Greece.[1] This package takes the form of loans made at market-based interest rates.

Figure 1 shows the sources of funds for the financial assistance package for Greece. Eurozone countries are to contribute €80 billion (about $105 billion) in bilateral loans. Each of the

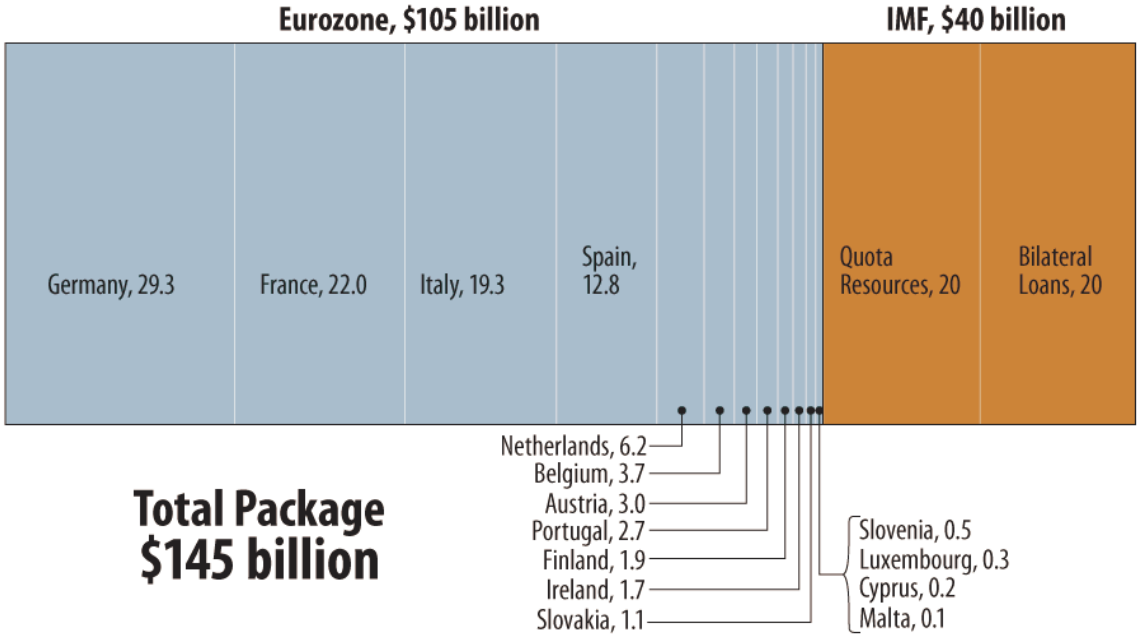
[1] For the Greek financial assistance package and the broader Eurozone financial assistance package, the exchange rate at the time the package was announced is used (approximately €1 = $1.31 and €1 = $1.27 respectively). Source: European Central Bank (ECB). However, currency swings are underway, and dollar conversions of data denominated in euros should be approached as estimates.

Eurozone countries (besides Greece) has pledged a bilateral loan, with the largest bilateral loans pledged by Germany and France (about $29.3 billion and $22 billion, respectively).

The IMF is to contribute a €30 billion (about $40 billion) loan.[2] Of the total, the IMF would draw half from IMF quota resources (the financial commitment countries make to the IMF upon joining) and half from bilateral lines of credit pledged by some member countries.

Figure 1. Eurozone/IMF Financial Assistance Package for Greece

Eurozone member state or IMF source of resources, Billion US$



Source: Graphic prepared by CRS using data from Jan Strupczewski, "Factbox - Progress Towards Approving Emergency Loans to Greece," *Reuters*, May 6, 2010; and IMF, "Frequently Asked Questions: Greece," May 11, 2010, http://www.imf.org/external/np/exr/faq/greecefaqs.htm#q23.

Notes: Eurozone member state commitments are bilateral loans, and some commitments are subject to parliamentary approval. IMF quota resources and bilateral loans fund a Stand-By Arrangement (SBA) loan for Greece. Conversion to dollars from euros using exchange rate of €1= $1.318.

It is worth noting that it is not clear how much of the €110 billion (about $145 billion) committed by the IMF and the Eurozone member states will be used by Greece. The money is disbursed in phases as Greece meets IMF loan conditions. If IMF officials say that Greece does not meet these conditions, IMF disbursements will not be made. Alternatively, if creditor confidence in Greece is restored and Greece can resume selling bonds on international capital markets at reasonable interest rates, the Greek government may not need to rely on Eurozone and IMF financial commitments. On the other hand, some economists have predicted that the financial package for Greece may not be sufficient to prevent Greece from restructuring its debt and/or exiting the Eurozone.

[2] The loan to Greece was approved by the IMF Executive Board on May 9, 2010.

What is the U.S. contribution to the IMF loan to Greece?

The IMF loan to Greece is to be financed by two different sources of money. Half of the IMF loan to Greece (about $20 billion) will be financed by IMF quota resources. IMF quotas are the financial commitments that IMF members make upon joining the IMF and are broadly based on the IMF member's relative size in the world economy. The U.S. contribution to IMF quota resources is 17%. However, we cannot infer that 17% of the IMF loan financed by IMF quota resources (about $20 billion) is from the United States. Once the IMF Executive Board approves a specific loan, there is an administrative decision made by the IMF as to which countries' quotas will be tapped to fund that particular loan. The IMF does not disclose parties on individual transactions, but over time aims to provide a balanced position for all members.

The other half (about $20 billion) of the IMF loan to Greece is expected to be financed by bilateral loans. These bilateral loans will become part of the IMF's supplemental fund, the New Arrangements to Borrow (NAB), when it becomes operational. They are available now, however, before the expanded NAB goes into effect. In 2009, the United States enacted legislation to extend a line of credit worth $100 billion as part of expanding the NAB. However, because the expanded NAB is not yet operational, this $100 billion line of credit from the United States cannot be tapped for Greece's package.

The United States has never lost money on its commitment to the IMF. All U.S. financial interactions with the IMF are off-budget and, because of accounting factors, do not result in any net outlays or have any impact on the U.S. federal budget deficit.

What is the IMF's creditor status in its loan to Greece?

The IMF, like the other international financial institutions, enjoys a de facto preferred creditor status; member governments grant priority to repayment of their obligations to the IMF over other creditors. In the case of the Greece loan, IMF loans would be repaid prior to all other creditors. Financing from European countries will be junior to the IMF's loan and will have the same status as existing Greek debt.

Who bears the risk of the IMF's loan to Greece?

The IMF's membership as a whole bears any risk from lending to Greece, but, in its entire history, no member of the IMF has experienced a loss from providing resources to the IMF, either by lending to the IMF or through the payment of quota subscriptions. Furthermore, member countries whose quota resources are chosen for a specific IMF loan have a claim on the IMF's balance sheet as a whole. Thus, even if U.S. quota is drawn for the Greece loan, which may be likely, any associated risk to the IMF's balance sheet due to the IMF loan to Greece would be shared by all IMF members. The IMF has preferred creditor status, which means that the IMF, along with other international financial institutions, is first in line to get repaid by the member country, ahead of other creditors. Occasionally countries fall into arrears with the IMF, but no member country has lost money as a result.

What reforms are part of Greece's package with the IMF?

The IMF does not disburse the full amount of its loans to governments at once. Instead, the IMF will divide the loan into tranches (French for "slice") and will only disburse the next tranche after verifying that the specified economic policy reforms have been met. Urging policy reforms in this way ensures that the loans will be repaid to the IMF, and that the required economic reforms are implemented.

The IMF program for Greece calls for substantial reductions in government spending as well as revenue increases. Overall, the package aims to reduce Greece's government budget deficit from 13.6% of GDP in 2009 to below 3% of GDP by 2014. The IMF has referred to this program as unprecedented in terms of the adjustment effort required by the government.[3] Some of the key reforms included in Greece's program with the IMF are listed below.

Key Elements of the Greece's Reform Package with the IMF

- **Government revenues.** Revenue measures are to yield 4% of GDP through 2013 by raising the value-added tax and taxes on luxury items, tobacco, and alcohol, among other items.
- **Revenue administration and expenditure control.** The Greek government is to strengthen its tax collection and raise contributions from those who have not carried a fair share of the tax burden. It is to safeguard revenue from the largest tax payers and strengthen budget controls. The total revenue gains and expenditure savings from these structural reforms are expected to gradually total 1.8% of GDP during the program period.
- **Financial stability.** A Financial Stability Fund, funded from the external financing package, is being set up to ensure a sound level of bank equity.
- **Entitlement programs.** Government entitlement programs are to be curtailed; selected social security benefits are to be cut while maintaining benefits for the most vulnerable.
- **Pension reform**. Comprehensive pension reform is proposed, including by curtailing provisions for early retirement.
- **Structural policies**. Government to modernize public administration, strengthen labor markets and income policies, improve the business environment, and divest state enterprises.
- **Cut military spending.** The plan envisages a significant reduction in military expenditure during the period.

Source: IMF, "Europe and IMF Agree €110 Billion Financing Plan With Greece," May 2, 2010, http://www.imf.org/external/pubs/ft/survey/so/2010/car050210a.htm.

In the end, IMF involvement was reportedly a key condition of German Chancellor Merkel's willingness to provide financial assistance to Greece. Some argue that the policy reforms (conditionality) attached to an IMF loan would lend additional impetus to reform and provide both the Greek government and the EU with an outside scapegoat for pushing through politically unpopular reforms. The EU would also make policy reforms a condition of loans, but the IMF is seen as more independent than the EU and has more experience in resolving debt crises than the EU. Some have also argued that IMF participation also reportedly enabled Eurozone countries to

[3] IMF, "Frequently Asked Questions: Greece," May 11, 2010, http://www.imf.org/external/np/exr/faq/greecefaqs.htm.

agree more easily on the terms and conditions of the loan program than might have been the case had they had to arrange it separately.

What is unusual about the Greece package with the IMF?

On the one hand, the IMF loan to Greece is a standard IMF program. The IMF lends to countries facing balance-of-payment difficulties, and it is widely agreed that Greece was facing substantial balance-of-payments problems. Greece, as a member of the IMF, is entitled to draw on IMF resources, pending approval by the IMF management. The procedure by which Greece obtained its loan from the IMF was standard, as was the specific IMF loan instrument to Greece (a three-year Stand-By Arrangement [SBA]).

On the other hand, Greece's program with the IMF is unusual for two reasons. First, since the late 1970s, the IMF has not generally lent to developed countries and has never lent to a Eurozone member state since the euro was created. That said, the IMF has had programs with countries in Europe before but, with the exception of Iceland's IMF program in 2008, IMF involvement in Europe has not been recent. For example, in the 1970s, the IMF had programs with the United Kingdom, Spain, and Italy. In the early 1980s, the IMF also had a program with Portugal.

Second, Greece's program with the IMF is unusual for its relative magnitude. The IMF has general limits on the amount it will lend to a country either through an SBA or Extended Fund Facility (EFF), which is similar to an SBA but for countries facing longer-term balance-of-payments problems. The IMF's guidelines for limits on the size of loans for SBAs and EFFs are 200% of a member's quota annually and 600% of a member's quota cumulatively.[4] IMF quotas are the financial commitments that IMF members make upon joining the IMF and are broadly based on the IMF member's relative size in the world economy. In "exceptional" situations, the IMF reserves the right to lend in excess of these limits, and has done so in the past. The IMF's loan to Greece is indeed exceptional access at 3,200% of Greece's IMF quota and is the largest access of IMF quota resources granted to an IMF member country.[5] Previously, the largest access had been granted to South Korea during the Asian financial crisis in the 1990s, at nearly 2,000% of Korea's quota resources.

What other policy options did Greece have?

Greece is addressing its sovereign debt crisis through a mix of fiscal austerity measures and structural reforms to improve the competitiveness of its industries. Many believe that the measures being implemented by the Greek government will lead to low levels of economic growth and increase unemployment. Financial assistance from the other Eurozone member states and the IMF is allowing the adjustment to take place over a longer period of time.

Greece could have addressed its sovereign debt crisis by restructuring its debt or by leaving the Eurozone. Some economists believe that Greece may still be forced to pursue one or both of these policy options. Debt restructuring, for example by negotiating with its bond holders to extend the maturity of Greek bonds or to take a cut in debt repayments, would alleviate immediate pressure

[4] IMF, "IMF Quotas," March 11, 2010, http://www.imf.org/external/np/exr/facts/quotas.htm.

[5] IMF, "IMF Reaches Staff-level Agreement with Greece on €30 Billion Stand-By Arrangement," press release, May 2, 2010, http://www.imf.org/external/np/sec/pr/2010/pr10176.htm.

on the Greek government's debt payments. However, debt restructuring could accelerate the contagion of the crisis to other Eurozone countries, as well as hinder Greece's ability to regain access to capital markets in the future.

Greece could also have addressed its sovereign debt crisis by leaving the Eurozone. This would require abandoning the euro, issuing a new national currency, and allowing the new national currency to depreciate against the euro. The Greek government would also probably have to put restrictions on bank withdrawals to prevent a run on the banks during the transition from the euro to a national currency. It is thought by some that a new national currency depreciated against the euro would spur export-led growth in Greece and offset the contractionary effects of fiscal austerity. Since Greece's debt is denominated in euros, however, leaving the Eurozone in favor of a depreciated national currency would raise the value of Greece's debt in terms of national currency and put pressure on other vulnerable European countries. Additionally, some argue that a Greek departure from the Eurozone would be economically catastrophic, lead to contagion to other European countries facing similar circumstances, and have serious ramifications for political relations among the European states and future European integration.

Eurozone/IMF Financial Assistance Package for other Eurozone Countries

Why did the Eurozone leaders pledge support to other Eurozone countries?

Despite the enactment of the Eurozone/IMF assistance package for Greece, investor concerns about the sustainability of Eurozone debt deepened during the first week of May 2010. Driven down by such fears, global stock markets plunged sharply on May 6, 2010, and the euro fell to a 15-month low against the dollar. Seeking to head off the possibility of contagion to countries such as Portugal and Spain, EU finance ministers agreed on May 9, 2010, to a broader €500 billion (about $636 billion) financial assistance package available to vulnerable Eurozone governments. Some analysts assert that such a bold, large-scale move had become an urgent imperative for the EU in order to break the momentum of a gathering European financial crisis. Investors initially reacted positively to the announcement of the new agreement, with global stock markets rebounding on May 10, 2010, to regain the sharp losses of the week before.

What financial assistance has been pledged by the EU and the IMF?

The bulk of assistance is to be provided through a new European Financial Stability Facility (EFSF). The facility, which expires after three years, raises funds by selling bonds and other debt instruments, backed by guarantees of Eurozone member states, on international capital markets. The EFSF can provide up to €440 billion (about $560 billion) in loans to Eurozone member states.

EU leaders also announced the creation of a new supranational EU balance of payments loan facility available to any EU member country facing financial difficulties. This facility, called the European Financial Stability Mechanism (EFSM) raises funds on international capital markets using the EU budget as collateral. The EFSM can provide up to €60 billion (about $76 billion) in

loans to EU members. The EFSM is similar in design to an existing €50 billion EU balance of payments facility that can only be drawn on by non-Eurozone EU member nations, including Latvia, Hungary, and Romania. No country to date has drawn on the EFSF or the EFSM.

EU leaders also suggested the IMF could contribute up to an additional €220 billion to €250 billion (about $280 billion to about $318 billion). This is in line with the Greece package, where the Eurozone states contributed roughly two-thirds and the IMF one-third of the total. IMF Deputy Managing Director John Lipsky reportedly later clarified the news reports about the IMF contribution to broader Eurozone stabilization efforts, saying that these pledges were "illustrative" of the support that the IMF could provide.[6] Reportedly, Lipsky reiterated that the IMF only provides loans to countries that have requested IMF assistance and that Greece is the only Eurozone country to date that has requested IMF assistance.[7]

Finally, the European Central Bank (ECB) also announced it would buy member state bonds in order to increase market confidence. This is an activity in which it had not previously engaged, and some view this action as a compromise to the central bank's independence. As of July 20, 2010, the ECB held around €60 billion of European government bonds.[8]

What is the role of the U.S. Federal Reserve?[9]

On May 9, 2010, the Federal Reserve (Fed) announced the re-establishment of temporary reciprocal currency agreements, known as swap lines, with the European Central Bank, Bank of Canada, the Bank of England, Bank of Japan, and the Swiss National Bank.[10] These arrangements have been authorized through January 2011.

Under these agreements the Fed swaps dollars for foreign currencies for a fixed period of time with interest being paid to the Fed on the dollar amounts involved. The swaps are repaid at the exchange rate at the time of the original swap, meaning that these repayment amounts are not affected by changes in exchange rates while the swap is outstanding. Thus, there is no exchange rate risk and, except in the unlikely event that the borrowing country's currency becomes unconvertible in foreign exchange markets, there is also no credit risk involved for the Fed. The highest recent outstanding amount was approximately $583 billion in December 2008.

The swap lines are intended to provide liquidity to banks in non-domestic denominations. For example, many European banks have borrowed in dollars to finance dollar-denominated transactions, such as the purchase of U.S. assets. Normally, foreign banks could finance their

[6] Bob Davis, "IMF's Reach Spreads to Western Europe," *Wall Street Journal*, May 10, 2010.

[7] Ibid.

[8] Andrew Ross Sorkin, "ECB Winds Down Debt Purchases," *New York Times*, July 20, 2010.

[9] Section prepared by (name redacted), Specialist in Macroeconomic Policy, Government and Finance Division, x7-..... For more on the Federal Reserve, see CRS Report RL30354, *Monetary Policy and the Federal Reserve: Current Policy and Conditions*, by (name redacted).

[10] In response to the beginnings of the recent financial crisis, similar swap lines were established in December 2007 and expired in February 2010. On the re-establishment of these lines, see Federal Reserve, "Federal Reserve, European Central Bank, Bank of Canada, Bank of England, and Swiss National Bank Announce Reestablishment of Temporary U.S. Dollar Liquidity Swap Facilities," http://www.federalreserve.gov/newsevents/press/monetary/20100509a.htm and Federal Reserve, "FOMC Authorizes Re-establishment of Temporary U.S. Dollar Liquidity Swap Arrangement with the Bank of Japan," http://www.federalreserve.gov/newsevents/press/monetary/20100510a.htm.

dollar-denominated borrowing through the private inter-bank lending market. Such private lending markets, however, have greatly diminished, if not disappeared, in periods of crisis over the past few years. Thus, central banks at home and abroad have taken a much larger role in directly providing liquidity to banks. The swap lines with the Federal Reserve provide foreign central banks with a source of dollar liquidity should such liquidity be needed.

IMF Resources and Congress's Role

How much money does the IMF have to lend?

In April 2009, the G-20 Leaders and the International Monetary and Financial Committee agreed to increase the resources available to the IMF through immediate bilateral financing from members and to subsequently expand the NAB and make it more flexible.[11] Resources from new bilateral contributions are available and being drawn on for current IMF programs. The expanded NAB is not yet operational.

As of July 15, 2010, the IMF has about $225.5 billion dollars immediately available to lend.[12] This figure is the IMF's one-year forward commitment capacity (FCC), which measures the IMF's ability to make new non-concessional resources available to members over the next 12 months. This includes, among other sources, unused quota resources, currently active bilateral loans to the IMF from several advanced economies, and note purchase agreements with three large emerging-market countries.[13]

What is the expanded New Arrangements to Borrow (NAB)?

Created in the late 1990s, the New Arrangements to Borrow (NAB) is a supplemental fund that the IMF can use to finance loans under exceptional circumstances that pose a threat to the international monetary system. The G-20 proposed in April 2009 that the existing NAB be expanded and made more flexible in light of increased demand for IMF assistance. Following a year of negotiations on the design and operations of the expanded NAB, the IMF Executive Board adopted a proposal on April 12, 2010, by which the NAB would be expanded to about $550 billion, with the addition of 13 new participating countries.[14] The U.S. commitment to the

[11] CRS Report R40578, *The Global Financial Crisis: Increasing IMF Resources and the Role of Congress*, by (name red acted) and (name redacted).

[12] 148.8 billion IMF Special Drawing Rights (SDRs). See IMF Financial Activities – Update May 6, 2010, available at: http://www.imf.org/external/np/tre/activity/2010/071510.htm. SDR/$ exchange rate used is 0.658957, as of July 27, 2010. See http://www.imf.org/external/np/fin/data/rms_five.aspx for SDR/$ exchange rates.

[13] The FCC is determined by the IMF's usable resources (including unused amounts under loans and note purchase agreements), plus projected loan repayments over the subsequent twelve months, less the resources that have already been committed under existing lending arrangements, less a prudential balance of 20% of the quotas of members that issue the currencies that are used in the financing of IMF transactions to "safeguard the liquidity of creditors' claims and take account of the potential erosion of the IMF's resource base." See IMF Financial Activities – Update May 6, 2010, for additional definitions.

[14] IMF Executive Board Approves Major Expansion of Fund's Borrowing Arrangements to Boost Resources for Crisis Resolution, *International Monetary Fund*, April 12, 2010.

expanded NAB is $100 billion and the necessary authorizations and appropriations were enacted in FY2009.[15]

Despite U.S. approval of its contribution to the expanded NAB in FY2009, the expanded NAB is not yet operational and U.S. resources pledged to it cannot be activated until a sufficient number of current and new participants provide formal consent. Participating in the expanded NAB involves domestic approval procedures in many countries, including legislative approval before they can consent or adhere to the expanded NAB. The IMF has not published the status of NAB approvals. Once the expanded NAB becomes operational, the bilateral loan and note purchase agreements would be folded into the NAB.

If and when the expanded NAB becomes operational, the process for approving use of NAB resources will change. Under the current NAB, NAB resources can be used if approval is secured from: (1) NAB participants representing 80% of total NAB credit arrangements; and (2) members of the IMF Executive Board representing 50% of the voting share. Use of NAB resources is currently considered on a loan-by-loan basis. Under the current NAB, the United States does not have sufficient voting power to unilaterally veto use of NAB resources.

Under the expanded NAB, the NAB would be activated for a period of time (up to six months). During this "activation period," calls can be made on the NAB without additional consent by the NAB participants or the IMF Executive Board. To activate the expanded NAB, it will be necessary to secure approval from: (1) NAB participants representing 85% of total NAB credit arrangements eligible to vote; and (2) members of the IMF Executive Board representing 50% of the voting share. Under the expanded and modified NAB, the United States will be able to unilaterally veto activating the NAB. If the expanded and modified NAB is activated, however, the United States will not be able to dictate or vote on which loans approved by the IMF Executive Board can be financed with NAB resources during the activation period.

How does the United States provide money to the IMF?

Since 1945, the United States has subscribed about $55 billion as its quota in the IMF. The Bretton Woods Agreements Act provides that, unless Congress agrees by law, the United States cannot provide money or subscribe resources to the IMF. Over the years, Congress has passed several laws authorizing the Secretary of the Treasury to agree that the United States will participate in IMF funding agreements and authorizing and appropriating the necessary funds. Congress has used a variety of budgetary arrangements to provide this money. A country's quota in the IMF is a line of credit, which is available to the IMF upon request when it needs money to fund a loan to one of its borrower countries. When the IMF wishes to draw against the U.S. quota, it asks the New York Federal Reserve Bank to transfer money from the Treasury Department's account to its account so it will have the resources necessary for that loan. The IMF usually draws on the resources of several countries to fund its loans. U.S. financial relations with the IMF are off-budget. For accounting reasons, payments to the IMF from U.S. quota resources have no outlay effect and no impact on the federal budget deficit. As loans are repaid to the IMF, it transfers the borrowed funds back to the United States. The IMF pays the United States and other countries interest on the outstanding balance whenever it uses their quota resources.

[15] To meet the U.S. $100 billion commitment to the expanded NAB, as well as an $8 billion increase in the U.S. quota at the IMF, Congress appropriated $5 billion in the FY2009 Spring Supplemental Appropriations for Overseas Contingency Operations (P.L. 111-32).

What is the role of Congress?

Once Congress has approved U.S. participation and provided appropriated funds to back an additional U.S. subscription, it has no further role in the IMF lending process. Neither individual loans nor the IMF's ability to draw against U.S. quota resources must be approved in advance by Congress. At the time the United States subscribes to new quota resources, it may not put restrictions on the ways the IMF may use those funds, as this would violate the terms of the IMF funding agreements. Congress may enact legislation requiring the U.S. executive director at the IMF to oppose loans to specific countries or for specific purposes. However, with 16.8% of the total vote, the United States cannot by itself block approval of loans by the IMF Executive Board.

Implications of the Eurozone Debt Crisis for the United States

How strong are the economic ties between the United States and the EU?

The United States and the European Union (EU) economic relationship is the largest in the world—and it is growing.[16] The modern U.S.-European economic relationship has evolved since World War II, broadening as the six-member European Community expanded into the present 27-member European Union. The ties have also become more complex and interdependent, covering a growing number and type of trade, investment, and financial activities.

In 2009, $1,252.0 billion flowed between the United States and the EU on the current account, the most comprehensive measure of U.S. trade flows. The EU as a unit is the largest merchandise trading partner of the United States. In 2009, the EU accounted for $220.6 billion of total U.S. exports (or 20.8%) and for $281.8 billion of total U.S. imports (or 18.1%) for a U.S. trade deficit of $73.2 billion. The EU is also the largest U.S. trade partner when trade in services is added to trade in merchandise, accounting for $173.5 billion (or 34.5% of the total in U.S. services exports) and $134.8billion (or 36.4% of total U.S. services imports) in 2009. In addition, in 2009, a net $114.1 billion *flowed* from U.S. residents to EU countries into direct investments, while a net $82.7 billion *flowed* from EU residents to direct investments in the United States.[17]

[16] For more information, see CRS Report RL30608, *EU-U.S. Economic Ties: Framework, Scope, and Magnitude*, by (name redacted).

[17] Data from CRS Report RL30608, *EU-U.S. Economic Ties: Framework, Scope, and Magnitude*, by (name redac ted).

What is the exposure of U.S. banks to vulnerable European countries?

Table 1. U.S. Banking Exposure to Greece, Ireland, Italy, Portugal, and Spain

Amounts Outstanding, Billions of US$, 2010 Quarter 1

Country	Amount
Greece	13.7
Ireland	73.8
Italy	51.8
Portugal	4.9
Spain	55.3
Total	**199.5**

Source: Bank for International Settlements (BIS), "Consolidated International Claims of BIS Reporting Banks," provisional data for 2010 Q1 (most recent data available), Table 9B: Consolidated Foreign Claims of Reporting Banks - Immediate Borrower Basis, http://www.bis.org/statistics/consstats.htm.

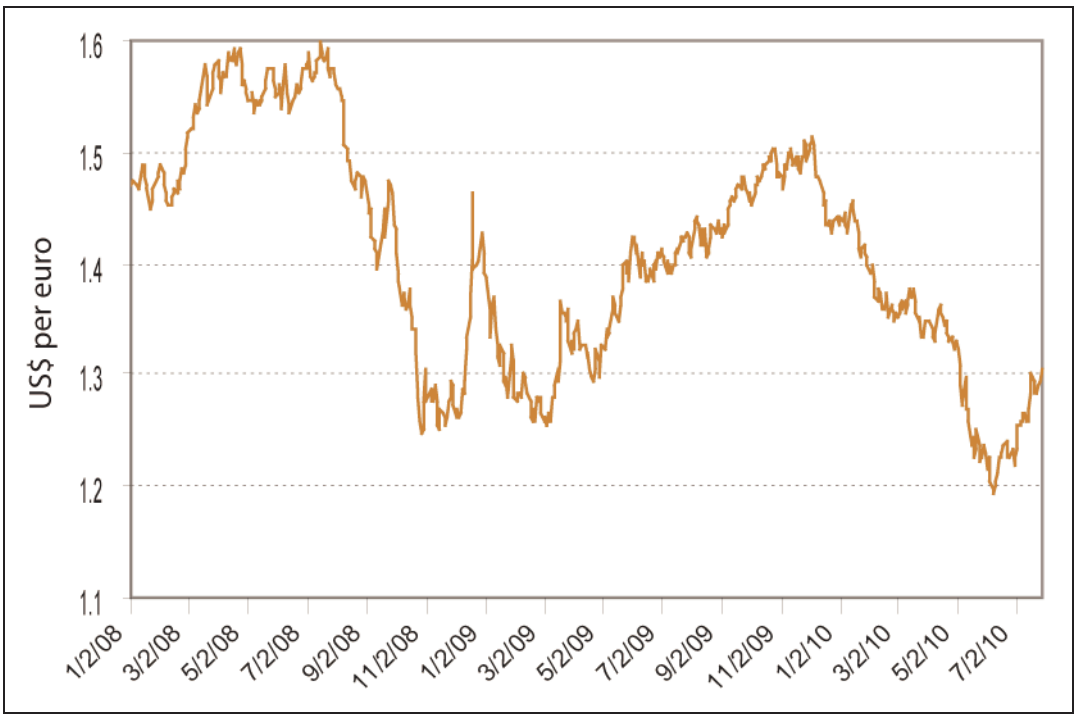
Notes: Provisional data. Figures may not add exactly due to rounding.

This table shows only direct bank lending. What is generally not known is the exposure of U.S. financial institutions through issuance of credit default swaps based on Greek sovereign debt. The effect of credit default swaps could be to lower U.S. bank exposure to sovereign debt by offsetting U.S. bank liabilities or to raise U.S. bank exposure to sovereign debt if U.S. banks sold credit protection.[18]

[18] For more on credit default swaps, see CRS Report RS22932, *Credit Default Swaps: Frequently Asked Questions*, by (name redacted) and (name redacted).

How has financial instability in the Eurozone affected the value of the dollar?

Figure 2. US$/Euro Exchange Rate, January 2008 – June 2010



Source: European Central Bank (ECB).

As investors lost confidence in the future of the Eurozone, and the size of the adjustment required for the Eurozone as a whole became apparent, the value of the euro began to weaken. The euro depreciated against the U.S. dollar by 21% between December 12, 2009 and June 8, 2010 (from 1.51 $/€ to 1.22 $/€; see **Figure 2**). A weaker euro likely lowers U.S. exports to the Eurozone and increases U.S. imports from the Eurozone, widening the U.S. trade deficit. On the other hand, it makes purchases and U.S. investments in Eurozone countries cheaper in dollar terms. Beginning in June, the value of the euro relative to the U.S. dollar has begun to rise but has not reached its pre-crisis levels (1.30 $/€ on July 27, 2010).

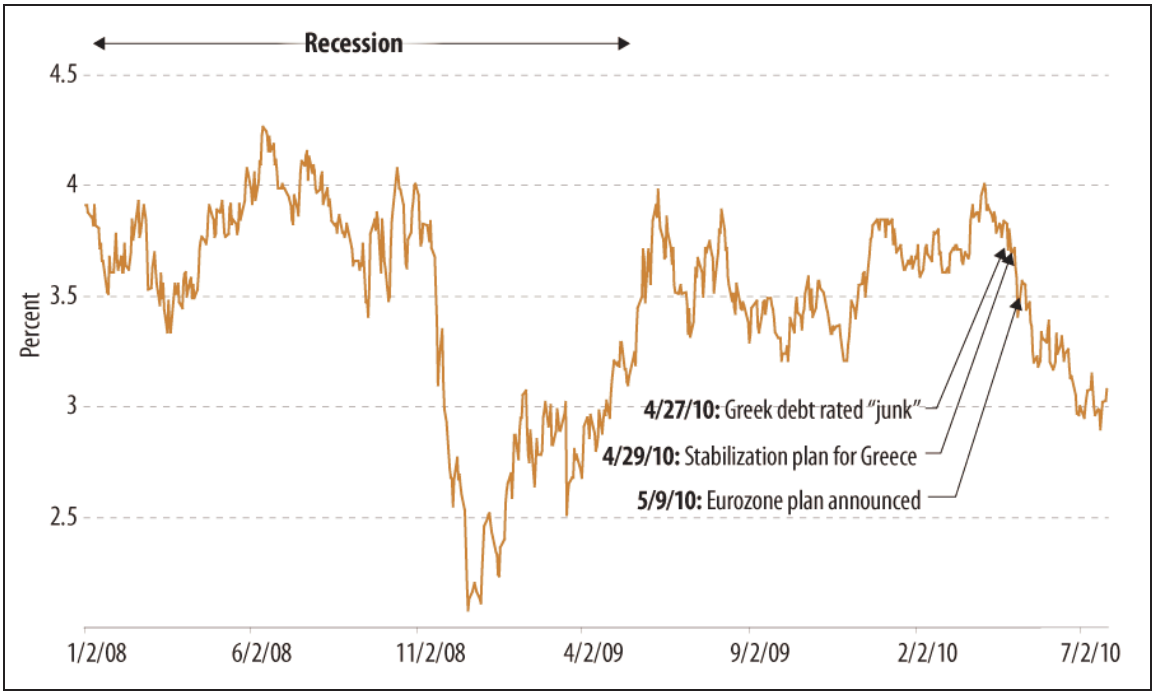
Since the Chinese renminbi has been tied to the value of the dollar, when the dollar appreciates against the euro, the renminbi also does so. This raises the price of Chinese exports to the Eurozone and lowers the price of European exports to China. This exchange rate effect not only affects China's trade with Europe, but it could make the United States a more attractive market for products from China.

How has the Eurozone instability affected U.S. interest rates?

Since U.S. Treasury securities are considered to be a safe haven for investors during times of economic turmoil, the immediate effect of the Greek crisis was for investors to reduce their exposure to euro-denominated investments, particularly those issued by Greece, and invest some of those funds in U.S. Treasuries. This caused a greater inflow of funds into the United States and

caused the yield on 10-year Treasury notes to fall about one-half of a percentage point (see **Figure 3**). This combined with further pessimism to bring the rate from 4% in April 2010 to about 3% in mid-July. If these lower interest rates persist, U.S. borrowers, including the U.S. Treasury and those seeking mortgages, will benefit. In June 2010, some long-term mortgage interest rates had fallen to as low as 4.25%. For those who rely on interest bearing assets for income, however, lower interest rates reduce the yields they receive on bonds and other securities. In the future, though, if other Eurozone member states default on loans to leveraged banks, global credit markets may shrink by a multiple of the losses as banks deleverage.[19] If this occurs, global interest rates, including those in the United States, could rise.[20]

Figure 3. Yields (Interest Rates) on U.S. 10-year Treasury Notes



Source: CRS with data from U.S. Treasury.

How will U.S. economic growth be affected?

The Eurozone instability is affecting the U.S. economy through several economic and financial linkages. The first is in capital flows into the "safe haven" of U.S. Treasury securities and causing lower interest rates as addressed above. The second is in international trade flows. Slower growth in the Eurozone likely will lead to lower U.S. exports there, while the fall in the value of the euro may further reduce the quantity of U.S. exports to the Eurozone but may increase U.S. imports from Europe and travel expenditures there. Slower growth in the Eurozone also is reducing demand for petroleum and lowering the price of oil and other commodities. This will tend to

[19] For example, see Frederic S. Mishkin, "On 'Leveraged Losses: Lessons from the Mortgage Meltdown'," Speech at the U.S. Monetary Policy Forum, New York, New York, February 29, 2008, http://www.federalreserve.gov/newsevents/speech/mishkin20080229a.htm.

[20] For more on this point, see CRS Report RL34412, *Containing Financial Crisis*, by (name redacted).

reduce the U.S. import bill for petroleum and tend to increase consumer confidence in the United States. The Eurozone instability, however, also has increased the risk level with respect to sovereign and other debt and has increased volatility in stock markets. While such volatility in the short-term may not affect the overall level of consumption and investment in the United States, a large drop in equity values may reduce consumption through the wealth effect as stockholders see their wealth levels shrink and attempt to save more. Corporations also may find that raising funds for investments through new offerings of stock becomes more difficult.

Figure 4 shows the amount that real U.S. gross domestic product (GDP) has changed between first quarter 2009 to first quarter 2010. During this time, real GDP increased by $313.2 billion. This consisted of an increase in consumption of $149.8 billion, an increase in investment of $124.7 billion, an increase in net exports of $13.6 billion, and an increase in government expenditures of $37.6 billion.

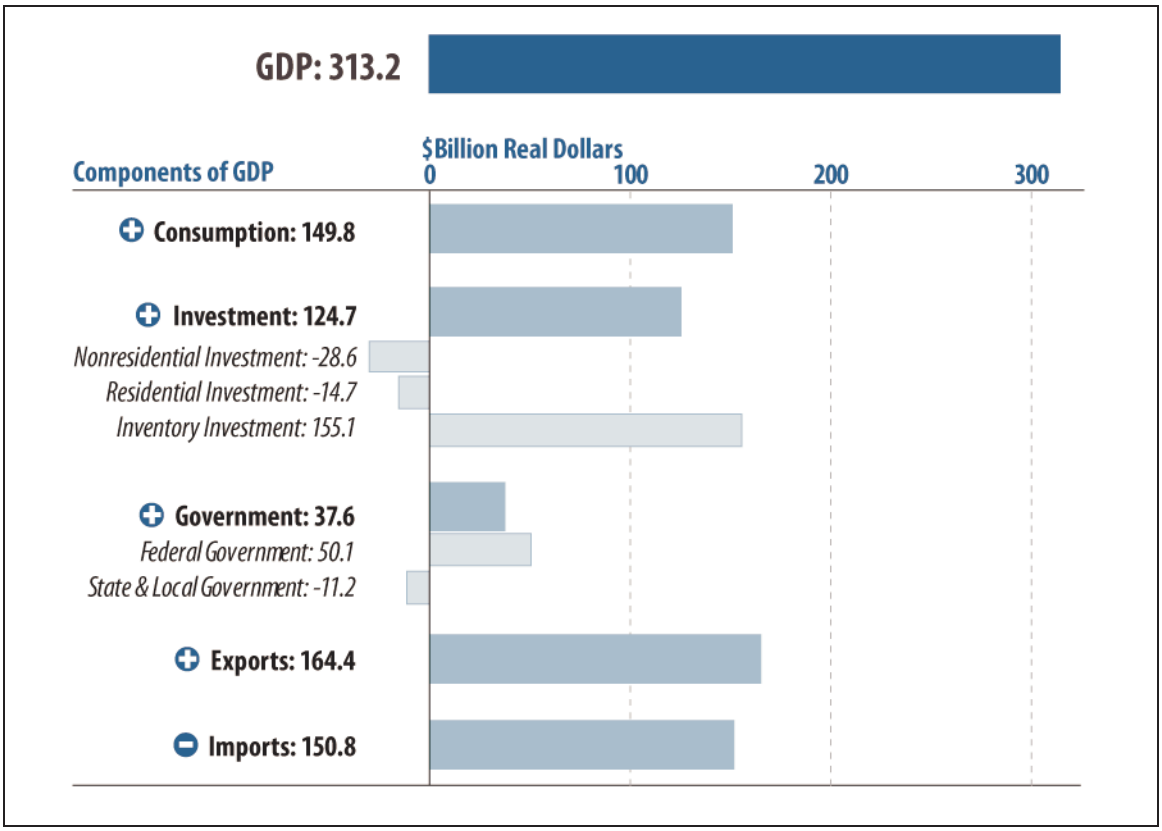
How will a drop in interest rates and price for petroleum combined with increased risk and a weaker euro affect household consumption, the largest component in GDP? The higher level of risk has decreased consumer confidence, but lower interest rates are expected to provide a boost to pent-up demand for consumer durables, the purchase of which tended to be postponed during the recession. Consumption is expected to increase in line with GDP. Investment, both by businesses in new plant and equipment and households in residential structures, is a key to U.S. recovery. As can be seen in **Figure 4**, the increase in U.S. investment over the past year has been in inventory accumulation as businesses restocked shelves in anticipation of rising sales. Growth in investments in plant and equipment and in housing has been negative. Lower interest rates provide a positive boost to investments in general, but business expectations of less export demand from Europe and increased risk of another global slowdown in growth may work to curtail new investments in production capacity. Also, the first-time homebuyer tax credit (part of the Housing and Economic Recovery Act of 2008, P.L. 110-289) expired in mid-2010, and was expected to have moved some housing demand forward. As for international trade, the drop in the value of the euro and weakened demand in the Eurozone are likely to increase the U.S. trade deficit beyond that expected as U.S. consumption of imports rises. With the exception of lower interest rates on borrowing, government spending, particularly at the state and local level, does not appear to be significantly affected by the Eurozone instability.

The combined effect of these positive and negative forces on U.S. growth is difficult to ascertain, but assuming that the crisis is contained, the net effect arguably will be mildly negative. IHS Global Insight stated that it thinks "the fallout from the Greek crisis for the United States is likely to be relatively small, mostly in the form of loss of competitiveness for U.S. exporters relative to a euro that should remain weak for the foreseeable future." It expects that the Eurozone crisis "will dent the U.S. recovery, but not derail it" and expects the growth rate of U.S. GDP to fall from 3.7% in first quarter 2010 and 2.4% (preliminary estimate) in second quarter of 2010 to the 2.2% to 2.6% range during the second half of 2010. In June 2010, IHS Global Insight expected the annual growth rate to reach 3.1%, but the preliminary second quarter estimate, a full percentage point below expectations, indicates that the economy's growth rate may be slowing to about 2.5% for 2010 [21] (The U.S. GDP contracted by 2.4% in 2009.) The Economist Intelligence

[21] IHS Global Insight, U.*S. Executive Summary*, *Aegean Contagion?*, May 2010; and U.S. Economy, Economic Commentary: GDP, updated **June 25, 2010**, accessed July 28, 2010. U.S. Bureau of Economic Analysis, *National Income and Product Accounts, Gross Domestic Product: Second Quarter 2010 (Advance Estimate)*, BEA News Release, BEA 10-37, July 30, 2010.

Unit expects U.S. growth to be 2.7% in 2010, down from the 3.3% expected in June 2010.[22] All of this reduced expectation in growth, however, cannot be attributed solely to the Eurozone crisis. Other factors are affecting growth in the United States (e.g., the winding down of the stimulus package).

Figure 4. Amount of Change in U.S. Real Gross Domestic Product by Component From First Quarter 2009 to First Quarter 2010



Source: Congressional Research Service with data from U.S. Department of Commerce via IHS Global Insight.

Notes: In billions of chained 2005 dollars, seasonally adjusted. GDP equals consumption plus investment plus exports minus imports plus government spending. Subcategories for investment (non-residential, residential, and inventory) and government spending (federal and state and local) are listed. GDP is estimated various ways and differs from the sum of these components by what is called a residual.

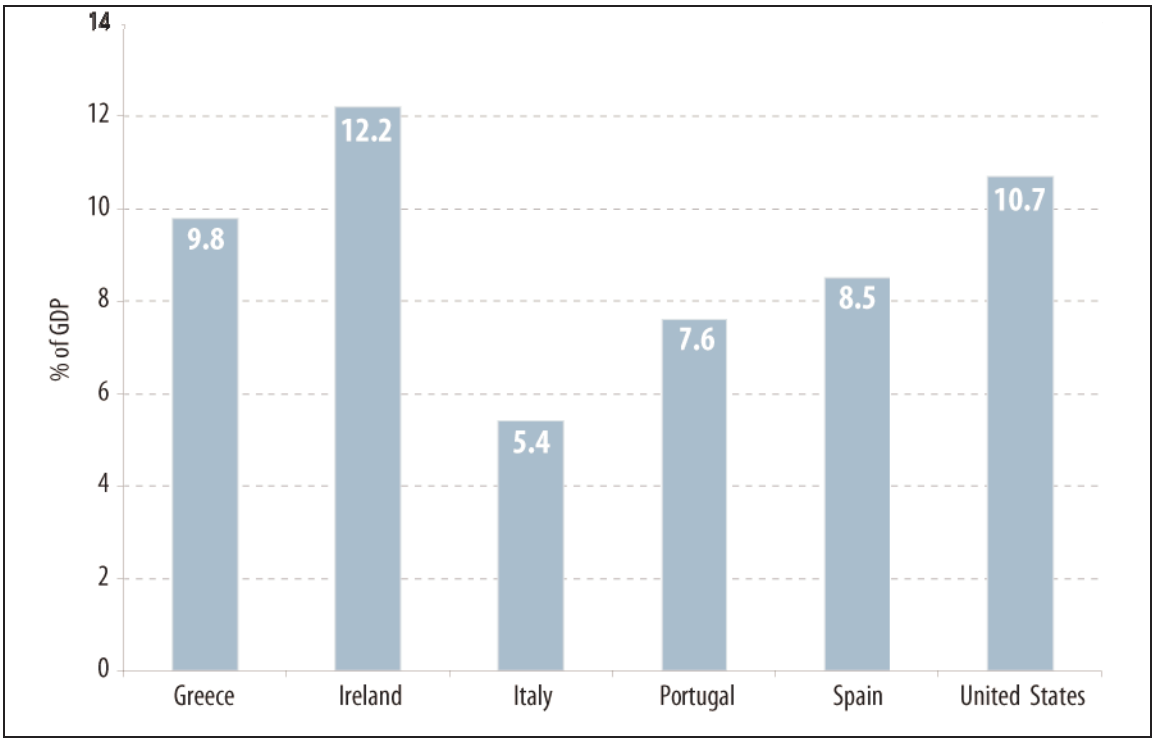
How do U.S. government budget deficit and external debt levels compare to those in vulnerable European countries?

Some are concerned that Greece's debt crisis foreshadows the United States' future. It is important to note that the sustainability of a government's debt depends on a host of different factors, such as the flexibility of the exchange rate, the currency in which the government has borrowed, and when the debt is falling due, among others. What may be sustainable for a

[22] Economist Intelligence Unit, *Forecast for the United States of America*, 2010, updated for August 1, 2010. Accessed July 28, 2010.

particular government in a particular time may not be true for other governments. Some have suggested, for example, that although the U.S. budget deficit situation is similar to those in vulnerable European countries, the U.S. fiscal position may be stronger than these other countries because, for example, the United States has a floating exchange rate, the dollar is an international reserve currency, the U.S. overall level of debt (as a percentage of GDP) is lower, and economic growth is (albeit slowly) returning in the United States.[23] The United States is also considered a safe haven for investments, making U.S. bonds attractive on private international capital markets and making it easier for the U.S. government to rollover its debt.

Figure 5. Government Budget Deficits, 2010 Forecasts



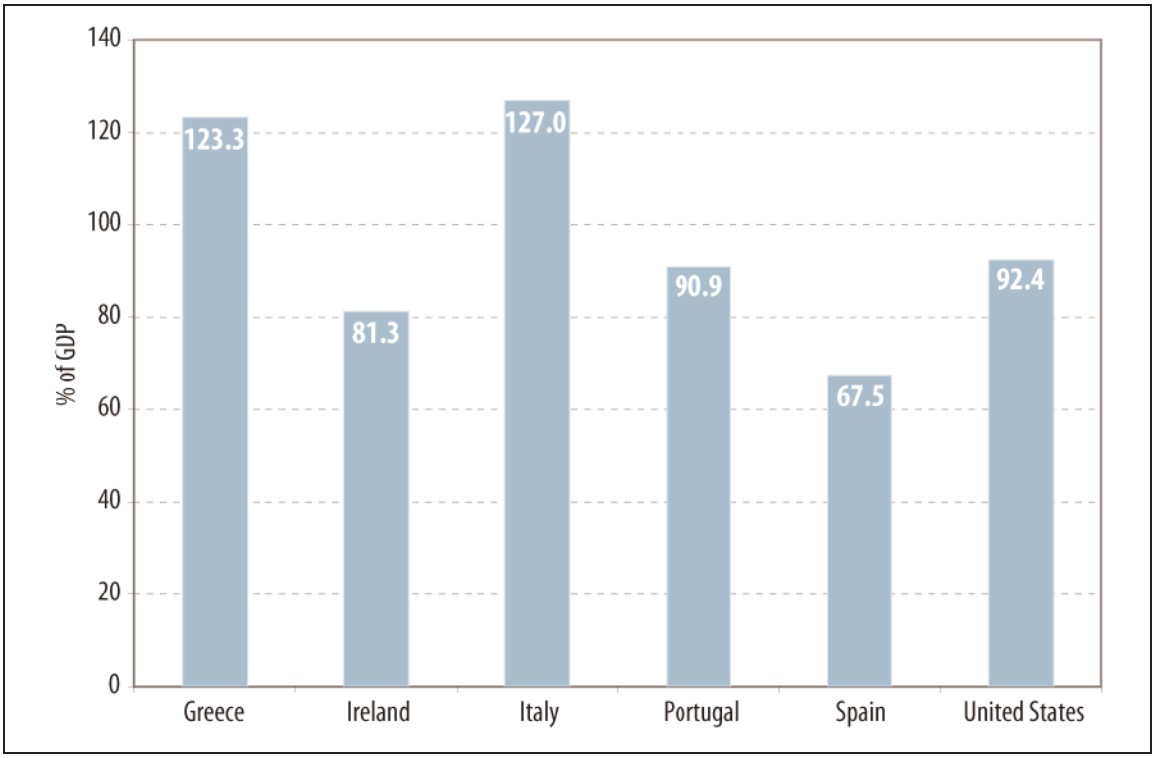
Source: OECD Economic Outlook (No. 87), May 2010.

Notes: Forecasts for general government.

[23] E.g., see Paul Krugman, "We're Not Greece," *New York Times*, May 13, 2011.

Figure 6. Public Debt, 2010 Forecasts

% of GDP



Source: OECD Economic Outlook (No. 87), May 2010.

Notes: Forecasts of general government gross debt.

Legislative Developments

Enacted Legislation

P.L. 111-203

On May 17, 2010, the Senate adopted (94-0) an amendment (S.Amdt. 3986), introduced by Senator John Cornyn, to S. 3217, the Restoring Financial Stability Act of 2010. The Senate passed its version of the financial regulatory reform bill (H.R. 4173), which included S.Amdt. 3986 on May 20, 2010. The Dodd–Frank Wall Street Reform and Consumer Protection Act (P.L. 111-203) was signed by the President on July 21, 2010.

The original version of the amendment, titled "Restrictions on Use of Federal Funds to Finance Bailouts of Foreign Governments," directed the U.S. Executive Director (USED) at the IMF to: evaluate any IMF loan to a country where the public debt exceeds GDP; determine and certify to Congress whether the loan "will be" repaid; and use the voice and vote of the United States to oppose any loans where such certification could not be made.

As written, the impact of the amendment was unclear. Large IMF packages to advanced economies appeared to be the Amendment's main concern. However, its provision would apply

to all such heavily-indebted countries. Thus, it might require the United States to oppose IMF loans to low-income countries with substantial debts. As of 2009, nine countries had public debt burdens greater than their GDP.[24] Several low income countries are near that level and might exceed it if their GDP levels shrank during the midst of a financial crisis that prompted them to seek IMF aid.

The House-Senate conference on the financial reform bill made changes in the original language of this amendment. Section 1500 of the new law specifies that U.S. representatives at the IMF must oppose loans to such heavily indebted countries if it is "not likely" that they will be repaid. Prospective IMF loans to low-income countries (those eligible at the World Bank only for loans from its concessional aid facility, the International Development Association) are exempted from this requirement. Lastly, instead of requiring a Treasury certification, the new law requires the Treasury Department to report regularly to Congress about conditions in any such heavily indebted country that received an IMF loan despite U.S. opposition. These reports would discuss the debt status of the borrower country, economic conditions affecting its vulnerability and its ability to repay, and its debt management status.

Pending Legislation

FY2011 State, Foreign Operations Bill

The House appears to be considering legislation based on the language of the original Cornyn amendment in the FY2011 State, Foreign Operations Bill. The House State-Foreign Operations Appropriations Subcommittee approved a draft FY2011 bill on June 30, 2010.[25] Congressional Quarterly reports that the draft bill includes an amendment proposed by Representative Granger that would require the Treasury Department to review every IMF loan to countries where the public debt level is greater than 60% the size of the GDP. If Treasury determines that the loan cannot be repaid, the United States must oppose the loan.[26]

H.R. 5299 and S. 3383

On May 13, 2010, Representative Mike Pence introduced H.R. 5299, a bill titled the "European Bailout Protection Act." Senator Jim DeMint introduced a companion bill, S. 3383, on May 18, 2010. Sec. 2 would require the Secretary of the Treasury to oppose any activation of the expanded New Arrangements to Borrow (NAB) facility that would fund directly or indirectly an IMF loan to a member country of the European Union if it or any other member of the EU has a public debt-to-GDP ratio greater than 60%. Sec. 3 would direct the Secretary to instruct the USED at the IMF to oppose any assistance directly or indirectly to an EU member if any other EU member

[24] Greece, Iceland, Italy, Jamaica, Japan, Lebanon, Singapore, Sudan and Zimbabwe, according to the Economist Intelligence Unit.

[25] In the absence of a FY2011 budget resolution, both the House and Senate have begun work on FY2011 funding legislation using committee-approved discretionary budget allocations. The State-Foreign Operations Subcommittee was allocated $53.9 billion in the House and $54.0 billion in the Senate.

[26] Joanna Anderson, *Panel Approves Fiscal 2011 State-Foreign Operations Appropriations*, at CQ.com, http://www.cq.com/display.do?dockey/cqonline/prod/data/docs/html/committees/111/committees111-2010063000276116.html@committees&metapub=CQ-COMMITTEEMARKUPS&searchIndex=2&seqNum=3.

had a debt-to-GDP ratio above that level. The bills state in their heading that the provisions are temporary, but no time limitation is provided.

Because of the size of its share, the United States can block activation of the expanded NAB facility by withholding support, if and when the expanded NAB comes into effect. This legislation would require the United States to oppose use of the NAB facility for any loans to European countries that have substantial public debts. Some suggest, however, that the legislation might also have unintended effects. For example, if this legislation had been in effect last year, the United States would have had to oppose all IMF loans to post-communist countries of Central and Eastern Europe that are members of the EU, even though most analysts agree that excessive levels of public indebtedness were not the source of their difficulties.

The bills seem to presume that the expanded NAB resources will be activated on a country-by-country basis and therefore loans to European countries can be blocked while loans to other countries may be approved. IMF member countries agreed in April 2010, however, that the expanded NAB will be activated for a set period of time (up to 6 months) and would be used to finance any applicable loans during that period. The United States has the power to prevent the NAB from being activated but it cannot veto specific borrowers. Under this legislation, the Secretary of the Treasury would need to keep the NAB shut indefinitely or risk the possibility that an EU country might unexpectedly seek to borrow during a period when the NAB has been activated.

This legislation might also prevent the existing bilateral lines of credit provided by some countries from being folded into the expanded NAB, since this would be done by reimbursing countries from the NAB for money the IMF had previously drawn from their bilateral credits. Bilateral credits were used to help fund the recent loan to Greece. Thus, if this legislation were in effect, the United States might have to oppose activation of the NAB for the purpose of reimbursing bilateral creditors for their share in the Greek loan.

Congress has taken no action on this legislation. However, the Granger amendment to the pending fiscal 2011 Senate-Foreign Operations Appropriations bill uses the 60% threshold. It might also be interpreted as requiring U.S. opposition to many proposed IMF loans, though the effect would not be limited solely to loans for European Union countries.

H.Con.Res. 279

On May 18, 2010, Representative McMorris Rodgers introduced House Concurrent Resolution 279 (H.Con.Res. 279), a measure that would disapprove U.S. participation in any IMF funding package for the EU, unless each EU member country complies with the EU rules on deficit spending and each had a public debt-to-GDP ratio at or below 60%. The legislation seeks to discourage or prevent U.S. resources being used to help fund the European financial stability plan announced on May 9, 2010. The legislation has been referred to the House Committee on Financial Services and no further action has been taken.

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