Calendar No. 705

106TH CONGRESS *2d Session*	SENATE	REPORT 106–354

INTERNATIONAL MONETARY STABILITY ACT OF 2000

REPORT

OF THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

TO ACCOMPANY

S. 2101

together with

ADDITIONAL VIEWS

JULY 24 (legislative day, JULY 21), 2000.—Ordered to be printed

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INTERNATIONAL MONETARY STABILITY ACT OF 2000

JULY 24 (legislative day, JULY 21), 2000.—Ordered to be printed

Mr. GRAMM, from the Committee on Banking, Housing, and Urban Affairs, submitted the following

REPORT

together with

ADDITIONAL VIEWS

[To accompany S. 2101]

The Committee on Banking, Housing, and Urban Affairs, to which was referred the bill (S. 2101) to promote international monetary stability and to share seigniorage with officially dollarized countries, having considered the same, reports favorably thereon with an amendment in the nature of a substitute and recommends that the bill (as amended) do pass.

INTRODUCTION

On July 13, 2000, the Senate Committee on Banking, Housing, and Urban Affairs (the Banking Committee) met in legislative session and marked up and ordered to be reported S. 2101, the International Monetary Stability Act of 2000, a bill to promote international monetary stability and to share seigniorage with officially dollarized countries, with a recommendation that the bill do pass, with an amendment in the nature of a substitute. The Committee reported the bill favorably by voice vote.

HISTORY OF THE LEGISLATION

The International Monetary Stability Act of 2000, S. 2101, was introduced on February 24, 2000, by Senators Connie Mack and Robert F. Bennett. The legislation introduced was similar to S. 1879, the International Monetary Stability Act of 1999, which was introduced on November 8, 1999 by Senator Mack. The purpose of

S. 2101 is to make it easier for other countries to adopt the U.S. dollar as their official currency.

The Subcommittee on Economic Policy and the Subcommittee on International Trade and Finance conducted two joint hearings on the issue of other countries adopting the U.S. dollar as their official currency. On April 22, 1999, the two subcommittees met in open session and heard and received written testimony from the Honorable Alan Greenspan, Chairman, Board of Governors of the Federal Reserve System; the Honorable Lawrence H. Summers, Deputy Secretary, Department of the Treasury; Dr. Wayne Angell, Chief Economist, Bear, Stearns & Co., Inc.; Dr. Judy Shelton, Member of the Board, Empower America; Dr. Guillermo Calvo, Director, Center for International Economics, University of Maryland; Dr. Catherine Mann, Senior Fellow, Institute for International Economics; and Dr. C. Fred Bergsten, Director, Institute for International Economics. On July 15, 1999, the two subcommittees met in open session and heard and received written testimony from the Honorable Manuel Hinds, Former Minister of Finance, Republic of El Salvador; Dr. Michael Gavin, Director of Economic Research for Latin America, Warburg Dillon Read, LLC; David Malpass, Director for International Economics, Bear, Stearns & Co., Inc.; and Dr. Liliana Rojas-Suarez, Managing Director and Chief Economist for Latin America, Deutsche Bank Securities, Inc.

The Subcommittee on Economic Policy conducted a legislative hearing to consider S.1879 on February 8, 2000. The Subcommittee received testimony from the Honorable Edwin M. Truman, Assistant Secretary for International Affairs, Department of the Treasury.

PURPOSE AND SUMMARY OF NEED FOR LEGISLATION

The purpose of the bill reported by the Banking Committee is to make it easier for other countries to adopt the U.S. dollar as their official currency.

Many emerging market countries have had a recurring problem with bad monetary policy. The effects of a history of bad monetary policy include high interest rates and a lack of long term lending in the local currency. High interest rates and a lack of long term lending stifle investment and job creation, make it difficult to purchase homes and other durable goods, and weaken local financial systems.[1] These problems, in combination with the traumatic events in emerging market countries in recent years and the creation of the euro, have generated interest in dollarization, particularly in Latin America.[2]

Much of Latin America is already dollarized on an unofficial basis.[3] Unofficial dollarization means that, despite the existence of a national currency, people often use the U.S. dollar for everyday transactions, bank deposits, and lending, and governments often

[1] Testimony of Manuel Hinds, Former Minister of Finance, Republic of El Salvador, Joint Hearing in the Subcommittee on Economic Policy and the Subcommittee on International Trade and Finance, July 15, 1999 at 27.

[2] Testimony of Lawrence Summers, Deputy Secretary of the Treasury, Department of the Treasury, Joint Hearing in the Subcommittee on Economic Policy and the Subcommittee on International Trade and Finance, April 22, 1999 at 5.

[3] IMF Occasional Paper #171, Monetary Policy in Dollarized Economies, International Monetary Fund, 1999.

issue debt denominated in dollars.[4] Official dollarization means a country eliminates its own paper currency and adopts the U.S. dollar as legal tender.[5] (Unless otherwise explained, references to dollarization in the remainder of the report refer to official dollarization.)

Panama, which has been dollarized since 1904, is the largest dollarized foreign country. Others include the Marshall Islands, Micronesia, Palau, Pitcairn Island, East Timor, the Turks and Caicos Islands, and the British Virgin Islands.[6] Ecuador enacted dollarization legislation earlier this year and, as of mid-July, had completed more than two-thirds of the process of swapping the local currency for dollars. El Salvador, Guatemala, and Costa Rica are all studying the possibility of dollarization.[7] Argentina has also considered dollarization.[8]

The potential benefits for countries that dollarize include greater economic growth, more fiscal discipline, stability for exporters and importers, lower inflation expectations, lower interest rates, deeper financial markets, lengthier loan maturities, insulation from instability caused by international capital flows, and greater economic integration with the United States (including more trade and investment).[9] The potential costs include losing the ability to run an independent monetary policy.[10]

An additional cost of dollarization for a country that dollarizes is a loss of seigniorage, which is the profit a country earns when it issues its own currency.[11] Seigniorage (roughly) equals the difference between the face value of a currency and the cost of printing it. If a country were to eliminate its own currency and adopt the U.S. dollar it would no longer earn seigniorage. Meanwhile, because more people would use the U.S. dollar, the United States would earn more seigniorage.[12]

The transfer of seigniorage from a country that dollarizes to the United States makes dollarization politically difficult for countries considering dollarization. First, the seigniorage loss could be perceived as a payment of "tribute" to the United States.[13] Second, seigniorage can be a significant portion of government revenue. For example, Argentina earns about $750 million per year in seigniorage, which equals about 20 percent of the country's education budget.[14]

The United States can substantially reduce the political problem of the loss of seigniorage by offering to rebate a portion of the

[4] Testimony of Michael Gavin, supra note 2 at 32–33.
[5] Testimony of Manuel Hinds, supra note 2 at 26. Staff Report, Issues Regarding Dollarization, Subcommittee on Economic Policy of the Senate Committee on Banking, Housing, and Urban Affairs, July 1999 at 2.
[6] Staff Report, Basics of Dollarization, Joint Economic Committee, January 2000 at 7.
[7] El Salvador Government Weighs Dollarization—Minister, Reuters, March 15, 2000; Hernandez, Edin, Guatemala Considers Adopting U.S. Dollar as Currency, Agence France Presse, February 22, 1999; Costa Rica Central Bank President Calls for Dollarization Study, Dow Jones International News Service, July 6, 2000.
[8] Oppenheimer, Andres, Latin America Considers U.S. Dollar, The Miami Herald, January 19, 1999.
[9] Testimony of Lawrence Summers, supra note 3 at 6; Testimony of Alan Greenspan, supra note 3 at 9; Testimony of Wayne Angell, supra note 3 at 23–24; Testimony of Manuel Hinds, supra note 2 at 28–29; Testimony of Michael Gavin, supra note 2 at 34.
[10] Testimony of Lawrence Summers, supra note 3 at 6.
[11] Testimony of Guillermo Calvo, supra note 3 at 30.
[12] Staff Report, Citizen's Guide to Dollarization, Subcommittee on Economic Policy of the Senate Committee on Banking, Housing, and Urban Affairs, September 1999 at 4.
[13] Testimony of Wayne Angell, supra note 3 at 25.
[14] Testimony of Michael Gavin, supra note 2 at 36.

amounts transferred to the United States.[15] The bill reported by the Banking Committee would establish a framework under which the Secretary of the Treasury (the Secretary) would have the authority to make rebates of seigniorage to countries that dollarize. If the bill results in a country dollarizing that would not otherwise have dollarized, then the rebates would come at no net cost to the United States.[16] The benefits to the U.S. of dollarization also include elimination of foreign exchange risk in business transactions, lower costs of doing business with dollarized countries, and larger and more stable export markets.[17]

DESCRIPTION OF LEGISLATION

The bill reported by the Banking Committee would create a standard offer of seigniorage rebates from the United States to countries that dollarize. The Secretary would have the authority to certify a country as officially dollarized. If a country is continuously certified for ten years it would then start to receive rebates of seigniorage. The payments would be financed by revenue the Treasury Department receives through the Federal Reserve System as a result of dollarization. The payments are designed to rebate 85 percent of the extra seigniorage earnings of the United States due to official dollarization in countries certified by the Secretary. The Secretary would have the authority to reduce payments to a country or decertify a country, thereby ceasing U.S. payments altogether. The bill makes it explicit that the Federal Reserve is not obligated to be a lender of last resort to dollarized countries, would not supervise their financial institutions, and would not consider their economic conditions when setting monetary policy.

Certification

The bill reported by the Banking Committee would give the Secretary broad discretion in deciding whether to certify a country as officially dollarized. The Secretary's latitude should encourage countries interested in official dollarization to cooperate fully with the United States. Certification is not an endorsement by the United States of the policies of a dollarized country. Certification simply represents a judgment by the Secretary that rebating seigniorage to a country is in the interest of the United States.

Before certifying a country as officially dollarized the Secretary would have to consider whether the country was in fact officially dollarized, had opened its banking system to foreign competition or met international banking standards, had engaged in advance consultations with the Secretary regarding dollarization, and had cooperated with the United States regarding money laundering and counterfeiting. As evidence of whether a country was in fact officially dollarized the Secretary would have to consider whether a country has ceased issuing a domestic paper currency, destroyed the materials used to print that currency, repurchased and extinguished the currency, ended the currency's legal tender status in

[15] Testimony of Wayne Angell, supra note 3 at 25; Testimony of Michael Gavin, supra note 2 at 36.

[16] Testimony of Edwin Truman, Assistant Secretary for International Affairs, Department of the Treasury, Hearing in the Subcommittee on Economic Policy, February 8, 2000.

[17] Testimony of Lawrence Summers, supra note 3 at 6; Testimony of Guillermo Calvo, supra note 3 at 31.

favor of legal tender status for the U.S. dollar, ceased making government payments in the domestic currency, and substantially redenominated prices, assets, and liabilities into U.S. dollars. The Secretary could consider any additional factors the Secretary deems relevant.

The Secretary may refrain from certifying a country even if it meets every factor listed in the legislation. On the other hand, the absence of any one or more of these factors does not preclude the Secretary from certifying a country as officially dollarized. Upon certification, the Secretary must issue a written statement explaining why that country has been certified.

Most of the factors the Secretary must consider have to do with whether a country is in fact officially dollarized. Destruction of the plates and dies used to print the domestic currency is a consideration because it indicates the level of commitment to dollarization. It would be difficult to re-introduce the domestic currency absent ready access to the plates and dies used to print such currency. The Secretary must consider a country's openness to foreign banking competition or compliance with international banking standards because an unstable banking system may limit the successfulness of dollarization. Panama, by far the largest country to be officially dollarized, allows foreign competition in its banking sector and that has been a source of stability.[18] The Secretary must consider cooperation with the United States on money laundering and counterfeiting because of the concern that a dollarized country could attract these activities.

The bill implicitly allows for the dollarizing country to continue issuing coins, as Panama does. That is why the first in the list of considerations, whether a country has ceased issuing a local paper currency, does not mention ceasing to issue coins. U.S. territories, such as Guam, are not eligible for payments because they already benefit from the seigniorage generated from the dollar. Territories are part of the U.S. federal system of spending and taxation, so through federal spending they already get back seigniorage that their citizens generate.

The bill makes it explicit that countries that are not certified by the Secretary as officially dollarized, and therefore unable to receive rebates of seigniorage, are free to dollarize unilaterally. In addition, nothing in the bill prevents the United States from establishing a separate agreement to rebate seigniorage to a particular country or group of countries, although such agreement would require a separate action by Congress to be legally binding.

Decertification

The bill describes the conditions under which a country can be decertified. A declaration of war by the United States against a country automatically causes decertification. There is no reason for the United States to pay an enemy. A country can also be decertified if the Secretary determines that it is no longer dollarized. The most obvious reason this would happen is that another currency displaces the dollar as the predominant paper money. A country might decide to issue a national currency again, or its residents

[18] Moreno-Villalaz, Juan Luis, Panama: No Central Bank, No Capital Controls, No Problem, The Wall Street Journal, September 10, 1999 at A19.

might prefer to use the euro or another currency rather than the dollar. If the dollar loses its predominance as the paper money of a country, the country is no longer generating the level of seigniorage presumed by certification, so it loses its right to a rebate of seigniorage. As with certification, the bill requires the Secretary to issue a written statement explaining the reasons for decertification, so as to provide accountability.

Payments

The bill establishes two formulae that would generally govern the amount of payments made to dollarized countries. The two formulae are designed to rebate 85 percent of the seigniorage a country transfers to the United States by officially dollarizing.

An example would be useful in explaining how the formulae were derived. Country X uses the peso as its currency. One peso is worth one U.S. dollar, and the country has 10 billion pesos in circulation. If its central bank has $10 billion worth of securities backing up the value of the pesos and the interest rate on these securities is 5 percent, then the country earns $500 million per year in seigniorage: 5 percent of $10 billion. If Country X were to dollarize it would have to use the $10 billion in securities on reserve at the central bank to buy U.S. dollars from the Federal Reserve. Once dollarized, Country X would no longer have the securities and would no longer earn seigniorage. The Federal Reserve would have an extra $10 billion in securities and would therefore earn an extra $500 million per year. The formulae are designed to rebate 85 percent of the $500 million. A country would not receive payments based on the extent to which it was already unofficially dollarized.

The Secretary would make a lump sum payment to a country after it has been continuously certified for ten years. The lump sum payment will be an 85 percent rebate for ten years worth of seigniorage, plus interest. After that, the Secretary would make much smaller payments every quarter year. The ten year delay acts as a safeguard to ensure that countries will not get any payments unless they are sufficiently committed to dollarization. Countries certified for less than ten years get nothing.

It is easier to understand the payment formula for the quarterly payments, so this will be explained first. The Secretary starts by taking the amount of U.S. dollars purchased by the country for the purpose of official dollarization. In Country X's case, this would be $10 billion. The Secretary would then multiply that amount by the prevailing short term interest rate on 90-day Treasury bills. Consistent with the above example, let's use 5 percent. After multiplying these together we get the amount of seigniorage Country X would have earned in the absence of dollarization: $500 million. The Secretary then multiplies this amount by 85 percent, as the rebate is only intended to be an 85 percent rebate. This amount ($425 million in the case of Country X) is then multiplied by 25 percent, because the payment is for a quarter year. At that point, Country X's payment would be $106,250,000 every three months. However, if Country X had maintained its own currency it is likely that its seigniorage earnings would have risen over time, along with increases in the amount of pesos in circulation. Hence, the formula adds an inflation adjustment, so that the amount of the payment to a country increases as the U.S. price level increases. For example, if the U.S. price level rises 50 percent in the twenty years after certification of Country X, then Country X will then get a quarterly payment of $159,375,000—50 percent more than $106,250,000.

The amount of the one-time lump sum payment depends on similar principles. The Secretary would start with the amount of U.S. dollars purchased by a country for the purpose of official dollarization. This amount would be multiplied by the average interest rate on 90-day Treasury bills during the full ten year waiting period. The amount would then be multiplied by 850 percent: 85 percent for ten years. The inflation adjustment would depend on the average price level during the full ten year period, compared to the price level at the time of certification. In addition, an interest component is added to compensate the country for having to wait ten years for the payment. The interest component is calculated by taking the average interest rate on 10-year Treasury bonds during the ten year waiting period and taking it to the power of 4.875. So, for example, if the 10-year Treasury bond has had an average yield of 6 percent, the lump sum payment would be multiplied by 1.06 to the power of 4.875. Why 4.875? An exponential factor of 4.875 is used because the country must wait an additional 9.75 years for the lump sum payment (the country would have to wait a quarter year anyhow even if quarterly payments started from the time of certification). Therefore, interest accumulates for 4.875 years on the median payment: half of 9.75 years.

If a country attempts to purchase more U.S. dollars than are needed in order to officially dollarize, so that it can receive artificially large payments from the United States, the Secretary may use the dollar value of the local currency in circulation prior to certification instead of the amount of U.S. dollars purchased by a country. The price index used for calculating payments is the same index used to calculate payments on inflation indexed U.S. Treasury securities. If this price index is discontinued the Secretary may, after consulting with the Bureau of Labor Statistics, substitute an alternative index. Similarly, if the 90-day or 10-year Treasury security is discontinued, the Secretary may substitute an appropriate alternative interest rate.

Payments would not be subject to the annual appropriations process, and the Secretary would make payments out of revenue received by the Treasury Department from the Federal Reserve. This source should easily provide enough revenue to make payments. In Fiscal Year 1999, the Federal Reserve paid the Treasury $25.9 billion; revenue from this source in Fiscal Year 2000 is expected to be $32.5 billion.[19] Official dollarization abroad should increase these amounts as more people use the U.S. dollar.

Despite the specific formulae, the Secretary has the authority to reduce payments to a country if the United States is losing revenue on the payments, because the payments over-represent the amount of extra seigniorage the United States is earning due to official dollarization in that particular country. For example, if a country were to be certified by the Secretary and subsequently have another currency become heavily used (such as the euro) the United States could be overpaying a country. In addition, the Secretary

[19] Historical Tables, Budget of the United States Government, Fiscal Year 2001 at 41.

has the authority to cancel payments to a country by decertification, explained above.

Previously dollarized countries

Eight countries were already dollarized before the bill was reported by the Banking Committee: Panama; Ecuador; three former U.S. trust territories that are now independent (the Marshall Islands, Micronesia, and Palau); and two British colonies (the Turks and Caicos Islands and the British Virgin Islands). Pitcairn Island was also previously dollarized, but because of its extremely small population (about 40 people) the bill omits it.

The bill could have simply omitted rebating seigniorage to previously dollarized countries. However, they could then have become certified by introducing a temporary national currency expressly for the purpose of circumventing the bill and gaining certification. Paying seigniorage to previously dollarized countries removes the incentive for such strategies and recognizes that it is fair to put previously dollarized countries on a similar basis to countries that dollarize after the bill is enacted.

The bill therefore allows rebates to countries that are previously dollarized. However, rebates to these countries must wait not only the initial ten years, but as long as it takes for enough new countries to dollarize so that 10 percent of the payments the United States makes to the newly-dollarized countries is equal to or larger than the payments that would be made to the previously dollarized countries. In theory, when a new country dollarizes it will eventually get a rebate of 85 percent of its lost seigniorage. The remaining 15 percent helps defray the costs to the Federal Reserve of managing a larger money supply, finances rebates to previously-dollarized countries, and leaves a small profit for the United States. Therefore a 10 percent requirement helps ensure that the costs of making rebates to countries that were previously dollarized come out of net gains for the United States from countries that are newly dollarized.

Previously dollarized countries do not have to purchase U.S. dollars from the Federal Reserve in order to dollarize. Hence the payment formula for previously dollarized countries uses 4 percent of a country's nominal U.S. dollar gross domestic product in 1997 as a surrogate for the amount of U.S. dollars in circulation. The figure of 4 percent corresponds to the low end of the international average of currency in circulation as a percentage of GDP. More complicated formulae would have been possible, but in every formula there is some element of arbitrariness, so a simple and uniform formula seems least open to dispute.[20]

Treasury Department concerns

Treasury Secretary Lawrence Summers sent a letter to Senator Mack, dated July 13, 2000, in which the Secretary expressed his reservations about the bill. The primary concern is that the dollarization issue is not yet sufficiently "ripe" to establish a framework under which the United States would offer to rebate seigniorage to dollarized countries.

[20] Staff Report, Encouraging Official Dollarization in Emerging Markets, Joint Economic Committee, April 1999 at 18–19.

However, in 1992, as chief economist for the World Bank, Lawrence Summers, said, “In the long run, finding ways of bribing people to dollarize, or at least give back the extra currency that is earned when dollarization takes place, ought to be an international priority. For the world as a whole, the advantage of dollarization seems clear to me.”[21] Now Ecuador is in the process of dollarization, and Argentina, El Salvador, Guatemala, and Costa Rica have all expressed an interest in dollarization. Countries are most likely to be able to dollarize successfully during periods of relative stability rather than during crises. Relative to 1995 and 1997–98, the current period is relatively stable for emerging market countries.

Answers to frequently-asked questions

Would the bill require countries to dollarize?

No. The bill would not impose dollarization on any country. The decision to dollarize would remain each country’s to make for itself.

What does the United States gain from the bill?

Bad monetary policy and devaluations abroad have been a source of volatility and slow growth in our export markets. At present the United States exports more to the 31 million people in Canada than to the 500 million people in all of Latin America.[22] Dollarization should result in faster economic growth and more purchasing power in Latin America, thereby creating larger markets for U.S. goods. In addition, dollarization should reduce currency risk, thereby helping U.S. investors. And by helping foreign governments strengthen their economies it would reduce the need to use U.S. taxpayers’ money to bail out countries due to sudden currency-related economic problems.

Why is this legislation important now?

Ecuador is in the process of dollarization right now. El Salvador, Guatemala, and Costa Rica are all considering dollarization. Argentina remains a candidate for dollarization. The bill would encourage countries to consider dollarization during periods of relative stability, when it is most likely to be successful, rather than during periods of economic crisis.

Is official dollarization right for all emerging market countries?

This issue is not addressed by the bill. The bill merely removes the obstacle of the seigniorage transfer to the United States. Countries would still refrain from official dollarization if they did not think it was in their best interests. In addition, if a country thinks official dollarization is in its best interests but the Secretary disagrees, the Secretary could refuse to rebate seigniorage.

[21] World Bank Discussion Paper #207, Proceedings of a Conference on Currency Substitution and Currency Boards, The World Bank, January 1992 at 32.

[22] Bureau of Economic Analysis, Department of Commerce.

Would dollarization eliminate the ability of countries to run an independent monetary policy?

Countries that dollarize would adopt U.S. monetary policy as their own. Independent monetary policies in emerging market countries have often aggravated rather than eased economic problems. Historically, the discretionary use of monetary policy has been a major source of instability in many countries.

Would other countries have a say in U.S. monetary policy?

No. The bill would not alter the structure or policy mandate of the Federal Reserve.

Would officially dollarized countries pressure the Federal Reserve to conduct monetary policy in their interests regardless of the U.S. economic situation?

According to Chairman Alan Greenspan, the Federal Reserve is already under foreign pressure, but this pressure does not lead the Federal Reserve to do things that benefit foreign countries to the detriment of the United States. Chairman Greenspan testified that official dollarization would not make the Federal Reserve more readily take such actions. He also noted that all of the monetary policy stances the Federal Reserve takes within its ordinary range of looseness to tightness would be improvements compared to what many countries have now.[23]

Official dollarization would leave countries without a central bank to serve as a lender of last resort during a banking crisis. Would this pressure the United States to adopt this role for dollarized countries?

First, the bill explicitly states that the United States is not obligated to serve as a lender of last resort to dollarized countries. Second, before certifying a country as officially dollarized, the bill requires the Secretary to consider whether a country has opened its banking system to foreign competition or met international banking standards. Either of these would greatly diminish the risk of a bank crisis. The presence of international banks has made Panama's banking system very stable. Third, a country could establish a lender of last resort facility outside its central bank. For example, Argentina has a $7 billion emergency line of credit with international banks.[24] The Treasury Secretary may hinge certification on establishment of this kind of line of credit.

How would official dollarization be implemented?

If a country decides to dollarize officially, its central bank would take the assets that back its currency and convert them into U.S. Treasury securities. It could do this in the financial markets. The central bank would then use the Treasury securities literally to buy dollar notes from the Federal Reserve. The country would then use the dollars to repurchase and retire the local currency. In the meantime, the country must cease issuing the local currency and

[23] Testimony of Alan Greenspan, supra note 3 at 14–15.

[24] Hausmann, Ricardo, Michael Gavin, Carmen Pages-Serra and Ernesto Stein, Financial Turmoil and the Choice of Exchange Rate Regime, Inter-American Development Bank (Paper presented at IADB Conference on New Initiatives to Tackle International Financial Turmoil, Paris), March 14, 1999.

cease accepting local currency for payments (except in exchange for dollars). Dollars would be used for taxes, wages, debts, loans, and bank deposits, just like in the United States.

Why not go country-by-country and have Congress examine each country's request for a rebate separately?

First, bills involving a particular country are likely to become magnets for all issues dealing with that country. Second, jealousy could result if one country gets a higher percentage rebate than another. (The bill reported by the Banking Committee offers a standardized 85 percent rebate.) And third, it would be destabilizing for a country's economy and financial markets for it to say it will dollarize if the U.S. offers a rebate and then have to wait while a bill winds its way through Congress, with all the ups and downs of the legislative process.

SECTION-BY-SECTION ANALYSIS

Section 1. Short title

Section 1 provides that the bill may be cited as the "International Monetary Stability Act of 2000."

Section 2. Findings and statement of policy

Section 2 sets out the findings and statement of policy of the Act. The "findings" of the Act state the importance of monetary stability to emerging market countries, the deficiencies of certain methods of achieving monetary stability, the benefits of official dollarization, and the ability of the United States to remove an obstacle to official dollarization by offering to rebate seigniorage to countries that officially dollarize. The "statement of policy" provides that the United States is not obligated to act as a lender of last resort to officially dollarized countries, consider their economic or financial conditions in setting monetary policy, or supervise their financial institutions. It also states that countries are free to officially dollarize unilaterally if they do not want rebates of currency profit from the United States.

Section 3. Certification

Section 3 provides the Secretary with authority to certify a country as officially dollarized upon the issuance of a written statement explaining why that country has been certified. The Secretary may certify a country as officially dollarized after considering whether it has in fact officially dollarized, opened its banking system to foreign competition or complied with internationally accepted banking principles, cooperated with the United States on money-laundering and counterfeiting issues, and consulted with the Secretary prior to certification. The Secretary can consider any other factors he deems relevant. The absence of any one or more of the factors does not preclude the Secretary from certifying a country as officially dollarized. The presence of all the factors does not require the Secretary to certify a country.

Section 4. Payments

Section 4 provides that ten years and three months after certification the Secretary will commence payments to the country every three months. The amount of these payments will depend on the amount of dollars the country purchased from the Federal Reserve in order to dollarize officially (or the dollar value of the local currency in circulation prior to certification, if less than the amount of dollars purchased by the country from the Federal Reserve), short-term interest rates in the United States, and changes in the U.S. price level, using the same inflation-adjustment to the one used to index payments on inflation-indexed Treasury securities. The payments are designed to rebate 85 percent of the currency profits the country would have earned had it not officially dollarized. In addition, ten years after certification, the Secretary will make a one-time lump sum payment to the country approximately equal to the amount of the quarterly payments that would have been paid during the first ten years had quarterly payments commenced upon certification, plus interest. The Secretary is given the authority to reduce payments to a country if he believes such payments would result in a net revenue loss to the United States. The payments are not subject to the annual appropriations process and are provided out of revenue paid the Treasury Department by the Federal Reserve.

Section 5. Previously dollarized countries

Section 5 provides the circumstances under which countries that were officially dollarized prior to this Act can receive payments. Panama, Ecuador, East Timor, the Marshall Islands, Micronesia, Palau, Turks and Caicos, and the British Virgin Islands may not receive payments from the Secretary until 10 percent of the payments to other countries under this Act equals or exceeds the payments that would be made to these countries. Payments to previously-dollarized countries will otherwise follow the same rules as payments to other countries, expect that instead of depending on the amount of dollars purchased from the Federal Reserve, payments will depend on nominal dollar gross domestic product in 1997.

Section 6. Decertification and payment cancellation

Section 6 provides that the Secretary may cease payments to a country if the U.S. declares war on it or if the Secretary issues a written public statement that the country is no longer officially dollarized. In making a determination of whether a country is no longer officially dollarized, the Secretary shall consider the same factors listed is Section 3 in determining whether to certify a country as officially dollarized.

Section 7. Regulations

Section 7 provides that the Secretary and the Federal Reserve System may issue regulations to carry out this Act.

Section 8. Expenses

Section 8 authorizes appropriations to the Secretary of such sums as necessary for expenses and payments under this Act.

CHANGES IN EXISTING LAW (CORDON RULE)

In the opinion of the Banking Committee, it is necessary to dispense with the requirements of paragraph 12 of the rule XXVI of the Standing Rules of the Senate in order to expedite the business of the Senate.

REGULATORY IMPACT STATEMENT

In compliance with paragraph 11(b) of the rule XXVI of the Standing Rules of the Senate, the Banking Committee makes the following statement regarding the regulatory impact of the bill.

The Committee has determined that this legislation will not result in a significant net increase in the regulatory burden that the Federal Government imposes. S. 2101 explicitly states that the supervision of financial institutions in dollarized countries remains the responsibility of those countries and not the Federal Reserve.

COST OF THE LEGISLATION

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, July 21, 2000.

Hon. PHIL GRAMM,
Chairman, Committee on Banking, Housing, and Urban Affairs, U.S. Senate, Washington, DC.

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed cost estimate for S. 2101, the International Monetary Stability Act of 2000.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is G. Thomas Woodward.

Sincerely,

STEVEN LIEBERMAN
(For Dan L. Crippen, Director).

Enclosure.

CONGRESSIONAL BUDGET OFFICE COST ESTIMATE

S. 2101—International Monetary Stability Act of 2000

Summary: S. 2101 would permit the Department of the Treasury to make payments to countries that officially adopt the U.S. dollar as their currency and maintain it as legal tender (known as dollarization) for at least 10 years. The bill would establish conditions for the Treasury to certify countries as eligible to receive such payments. When a specified amount of dollarization occurs, the bill also would permit payments to be made to countries that dollarized prior to the bill's passage. No payments would be made to any of the eligible countries until at least 10 years after certification by the Treasury.

CBO estimates that enacting S. 2101 would increase governmental receipts by $90 million over the 2001–2005 period and by about $1 billion over the 2001–2010 period. Because countries could not receive payments until after 2010, CBO estimates that enacting the bill would only have a negligible effect on direct spending over the 2001–2010 period. In 2013, CBO estimates that the bill would require the Secretary of the Treasury to pay about $980 million to countries that have been continuously dollarized under the bill's provisions for 10 years, followed by additional payments each quarter. CBO estimates that implementing the bill's provisions would have no significant effect on spending subject to appropriation. Because the bill would affect governmental receipts (revenues) and direct spending, pay-as-you-go procedures would apply.

The bill contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act (UMRA) and would not affect the budgets of state, local, or tribal governments.

Description of the bill's major provisions: The bill would offer countries that adopt the U.S. dollar as their official currency a share of the income that the United States would earn from issuing the additional dollars needed to satisfy their total currency needs. The United States, like all countries, earns seigniorage—that is, a profit—on the currency it produces and places into circulation, currently about $25 billion a year. To the extent that the dollar displaces other currencies around the world, the United States would increase these seigniorage earnings while other countries lose seigniorage.

Under S. 2101, a country would receive payments if it adopts the U.S. dollar as its sole legal tender and is certified by the U.S. Treasury as meeting other requirements specified in the bill, and maintains the dollar as its currency for at least 10 years. To dollarize, the country would use eligible liquid reserves held by its central bank to purchase dollars from the Federal Reserve. Ten years after certification, the dollarizing country would become eligible for quarterly payments from the Treasury that are equal to 85 percent of the 90-day Treasury bill interest rate times the value of dollars acquired by the country up to the dollar value of the local currency in circulation at the time of conversion, increased by the change in the U.S. Consumer Price Index for All Urban Consumers (CPI–U), from the date of dollarization.

In addition, 10 years after certification, the dollarizing country would receive a lump-sum payment from the Treasury that approximates the value of the payments it would have received had the quarterly payments commenced immediately upon certification and the interest that would have accrued using the rate on the 10-year Treasury bond. After the lump-sum payment, countries would receive the additional quarterly payments as specified above. Countries that dollarized prior to passage of the bill become eligible for payments (85 percent of the interest earnings on 4 percent of their GDP), if their prospective payments would be less than 10 percent of the payment to newly dollarized countries.

Estimated cost to the Federal Government: The estimated budgetary impact of S. 2101 is shown in the following table. For the purposes of this estimate, CBO assumes that S. 2101 will be enacted by the end of fiscal year 2000. We assume that the Treasury would begin certifying dollarized countries in fiscal year 2003.

	By fiscal year, in millions of dollars—				
	2001	2002	2003	2004	2005
CHANGES IN REVENUES [1]					
Estimated revenues	−4	([2])	15	29	51

[1] S. 2101 would also increase direct spending. Over fiscal years 2001–2005, CBO estimates such amounts would not be significant. Beginning in 2013, CBO estimates such amounts would be substantial, with the first payment totaling $980 million.
[2] Less than $500,000.

Basis of estimate

The budgetary effect of S. 2101 cannot be estimated with a great degree of confidence because of the unavailability or unreliability of certain data necessary for the analysis. Existing estimates of dollar use abroad vary in quality. Moreover, it is difficult to predict the demand for currency and deposits that would exist in a country if the dollar were legal tender. Most critically, an assessment of the likelihood that countries will dollarize either with or without enactment of the bill is necessarily subjective.

CBO identified 10 countries that might have a significant probability of dollarizing their economies. Ecuador is already in the process of officially dollarizing in the absence of the legislation, and is classified in the bill with the other already-dollarized countries: East Timor, Marshall Islands, Micronesia, Palau, Panama, Turks and Caicos Islands, and the British Virgin Islands.

To calculate the revenue impact of the bill over the next 10 years, CBO assumes that currency and bank deposits will remain at their current ratios to GDP (gross domestic product) in each of the countries we identified as potentially dollarizing. The amount of currency needed in each dollarized country includes not only currency in circulation (less dollars already present in the country), but cash needed for bank reserves. CBO assumes that each country's banking system requires cash reserves of 25 percent of its M1 deposits (demand deposits). The figure of 25 percent approximates the combined central bank and commercial bank dollar reserves in Argentina, which requires that all banks maintain reserves in U.S. dollars.

To estimate the amount of local currency in circulation in each year in each potentially dollarizing country, CBO increased the most recent estimates available from the International Monetary Fund (IMF) by the nominal growth (or predicted growth) of each country. For the value of U.S. dollars currently circulating in each country, CBO made estimates based on data from the Federal Reserve.

For this cost estimate, CBO assumes that the probability that each country would officially dollarize before the enactment of S. 2101 is between 6.6 percent and 33.3 percent. CBO assumes that enacting S. 2101 would increase all the countries' probabilities of dollarizing by about 25 percent. This cost estimate is probabilistic; the costs are computed by multiplying the countries' currency demand under dollarization by their respective probabilities of dollarizing, which are phased in slowly over 10 years, from 1 percent of the probability of dollarizing in 2001 to 100 percent of the probability in 2010.

Finally, CBO assumes that currency demands will be limited to bills. We assume that countries would continue to provide their own coins under the legislation.

Revenues.—CBO expects that S. 2101 would likely increase the number of countries that officially dollarize. The additional currency required by such countries would generate additional interest income for the Federal Reserve beginning in 2002. This interest income is based on the current Federal Reserve patterns of portfolio holdings. The additional currency demand also would increase currency production and processing costs for the Federal Reserve. CBO estimates this cost would be similar to the current costs of issuing and processing U.S. currency. We assume that for the countries that dollarize, the distribution of denominations, longevity of individual bills, and frequency with which the Federal Reserve processes bills would be similar to those in the United States. In addition, CBO assumes that the Federal Reserve would establish additional facilities to distribute and return currency under its Extended Custodial Inventory Program, and incur travel and other costs associated with monitoring the additional currency use. As a result, CBO's estimate of the additional interest earnings each year from enacting S. 2101 is the sum of the increase in interest earnings from the additional currency in circulation less the increase in costs to the Federal Reserve from the additional currency.

Because the Treasury would need time to issue regulations and establish certification procedures, CBO expects that countries could not be certified as officially dollarized until 2003. As a result, CBO expects that countries that might have otherwise dollarized in 2001 without S. 2101 would wait until the specifics of the Treasury's certification requirements are reasonably certain. Hence, CBO estimates the bill would reduce dollarization and dollar use in 2001 from the levels assumed in the baseline. Beginning in 2002, CBO estimates the bill would increase dollarization and the revenues from dollarization.

Because of the initial slowing of dollarization described above, CBO estimates that the United States would forgo $4 million in federal revenues in 2001. Since CBO expects gradually increasing probabilities of dollarization, the estimates of increased revenues grow over the 2002–2010 period to reflect the phase-in of those probabilities. We estimate increases in revenues of $15 million in 2003, growing to about $50 million by 2005, and to more than $300 million by 2010.

Direct Spending.—Payments made to countries—representing their share of the seigniorage from dollarization—would be recorded in the budget as outlays. CBO estimates that no payments would be made to the dollarizing countries until 2013. We estimate that payments in that year would be $980 million and would grow thereafter. The bill authorizes the payments to be made from receipts deposited by the Federal Reserve with the Treasury.

In addition, S. 2101 would authorize the Treasury to pay its expenses to implement the bill's provisions without further appropriation. CBO estimates that such costs would increase direct spending by less than $500,000 a year.

Pay-as-you-go considerations: The Balanced Budget and Emergency Deficit Control Act sets up pay-as-you-go procedures for legislation affecting direct spending or receipts. The net changes in governmental receipts that are subject to pay-as-you-go procedures are shown in the following table. The bill would not have a significant effect on outlays from direct spending until after 2010. For the purposes of enforcing pay-as-you-go procedures, only the effects in the current year, the budget year, and the succeeding four years are counted.

	By fiscal year, in millions of dollars—										
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Changes in receipts	0	−4	0	15	29	51	80	118	169	231	311
Changes in outlays	0	0	0	0	0	0	0	0	0	0	0

Intergovernmental and private-sector impact: The bill contains no intergovernmental or private-sector mandates as defined in UMRA and would not affect the budgets of state, local, or tribal governments.

Previous CBO estimate: On May 23, 2000, CBO transmitted a cost estimate for S. 2101, the International Monetary Stability Act of 2000, as introduced. CBO estimated that version of the bill would increase direct spending by $422 million over the 2001–2005 period and $4,012 million over the 2001–2010 period. The difference between the estimate for the bill as introduced and this version is the result of the 10-year delay in payments of seigniorage to officially dollarized countries that is incorporated into the bill as ordered reported by the committee. Hence, the estimate for the introduced bill includes increased outlays beginning in 2003. In addition, the delay in payments would reduce the incentive to dollarize under the bill, so that the estimates of additional revenues from dollarized countries in this cost estimate are also smaller under the bill as ordered reported than for the version as introduced.

Estimate prepared by: Federal costs: Carolyn Lynch and Thomas Woodward; impact on State, local and tribal governments: Susan Sieg Tompkins; impact on the private sector: Patrice Gordon.

Estimate approved by: Peter H. Fontaine, Deputy Assistant Director for Budget Analysis; G. Thomas Woodward, Assistant Director for Tax Analysis.

ADDITIONAL VIEWS

The lead sponsor of S. 2101, International Monetary Stability Act of 2000, Senator Mack, has sought to bring to the attention of the Congress, the Administration, and the public the issue of dollarization in a serious and responsible manner. He believes strongly that dollarization holds significant promise for countries that choose to dollarize, as well as potential benefits to the United States.

Dollarization, however, is a complex and in some respects highly technical issue. The Secretary of the Treasury, Lawrence Summers, has sent a letter expressing reservations about the legislation. The letter states:

> As the Administration has indicated in the past, responsible dollarization may be a sensible decision for a government to make. However, we believe that it is fundamentally a unilateral sovereign decision.
>
> We believe the United States should remain open to the possibility of sharing seigniorage revenues, after full Congressional authorization and consultation, with countries that dollarize under the right circumstances. We do not believe, however, that there is a compelling reason for the United States at this time to establish a framework to permit us to share seigniorage. Such a framework would raise a number of complex political, economic, foreign policy issues, and U.S. budget issues (such as a likely paygo cost for budget purposes). These issues and the establishment of a framework for sharing seigniorage should be more fully debated and decided.
>
> Consequently, the Administration does not think the time is ripe for this legislation and cannot support it at this time.

The full text of the letter is included at the end of these remarks. I share at least some of the concerns of the Treasury Department. The Committee's action in reporting this legislation out on a voice vote recognized the conscientious and thoughtful manner in which Senator Mack has sought to address this issue. However, it was done with the understanding on the part of at least some members of the Committee that there would be efforts to address the concerns expressed by the Treasury before further Senate action would be taken on this legislation.

PAUL S. SARBANES.

DEPARTMENT OF THE TREASURY,
Washington, DC, July 13, 2000.

HON. CONNIE MACK,
U.S. Senate,
Washington, DC.

DEAR SENATOR MACK: I understand that the Banking Committee intends later this week to consider your proposed legislation, S. 2101, "The International Monetary Stability Act of 2000," which would authorize the Treasury Department to share seigniorage revenues with countries that adopt the United States Dollar as their official currency. I would like to take this opportunity to offer our views on this proposal.

Your thoughtful, forward-looking leadership on this issue has contributed enormously to the intellectual debate on this important policy issue, and has expanded public awareness of both the potential benefits and costs of dollarization and seigniorage-sharing. We very much appreciate your efforts.

As the Administration has indicated in the past, responsible dollarization may be a sensible decision for a government to make. However, we believe that it is fundamentally a unilateral sovereign decision.

We believe the United States should remain open to the possibility of sharing seigniorage revenues, after full Congressional authorization and consultation, with countries that dollarize under the right circumstances. We do not believe, however, that there is a compelling reasons for the United States at this time to establish a framework to permit us to share seigniorage. Such as framework would raise a number of complex political, economic, foreign policy issues, and U.S. budget issues (such as a likely paygo cost for budget purposes. these issues and the establishment of a framework for sharing seigniorage should be more fully debated and decided.

Consequently, the Administration does not think the time is ripe for this legislation and cannot support it at this time. However, we look forward to continuing our dialogue with you and others in Congress on this important subject.

Sincerely,

LAWRENCE H. SUMMERS.

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