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Estimating the Cost of Contributions to the IMF

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According to press reports, the Senate Appropriations Committee will, in response to a request from the Obama Administration, attach a $108 billion increase in funding for the International Monetary Fund to a supplemental wartime spending bill. This will happen as early as today (Thursday, May 14).

This is a surprise and controversial move, and may succeed in avoiding the hearings and debate that would normally accompany such an important appropriation. In order to make this politically feasible, the administration has argued that the true cost of this $108 billion contribution to the IMF is actually zero. The non-partisan Congressional Budget Office (CBO) did not accept this argument, but is expected to present a figure that is very low; as this goes to press it is reportedly at $5 billion.

This figure is much too low; as will be seen below, while any estimate can only be approximate, the basic principles by which such an estimate can be derived are relatively straightforward. Such basic principles indicate a much higher cost to the Treasury, of at least $16.6 to $26.3 billion.

The argument for scoring it at zero was that the contribution is "an exchange of assets" with the IMF. The idea is that the Treasury loans $108 billion to the IMF, and receives in exchange a corresponding increase in its reserve position in the Fund. This argument is not valid, and was correctly rejected by the CBO.

The problem is that although the United States theoretically has the right to draw on IMF Funds, in case of a balance of payments need, it has not done so since the 1970s. Despite the severity of the current recession, the United States has not drawn on IMF funds for decades, and it is extremely unlikely that the United States would ever draw on these funds. Therefore, these funds should be looked at as a permanent contribution to the Fund, as all other contributions for the last three decades have turned out to be.

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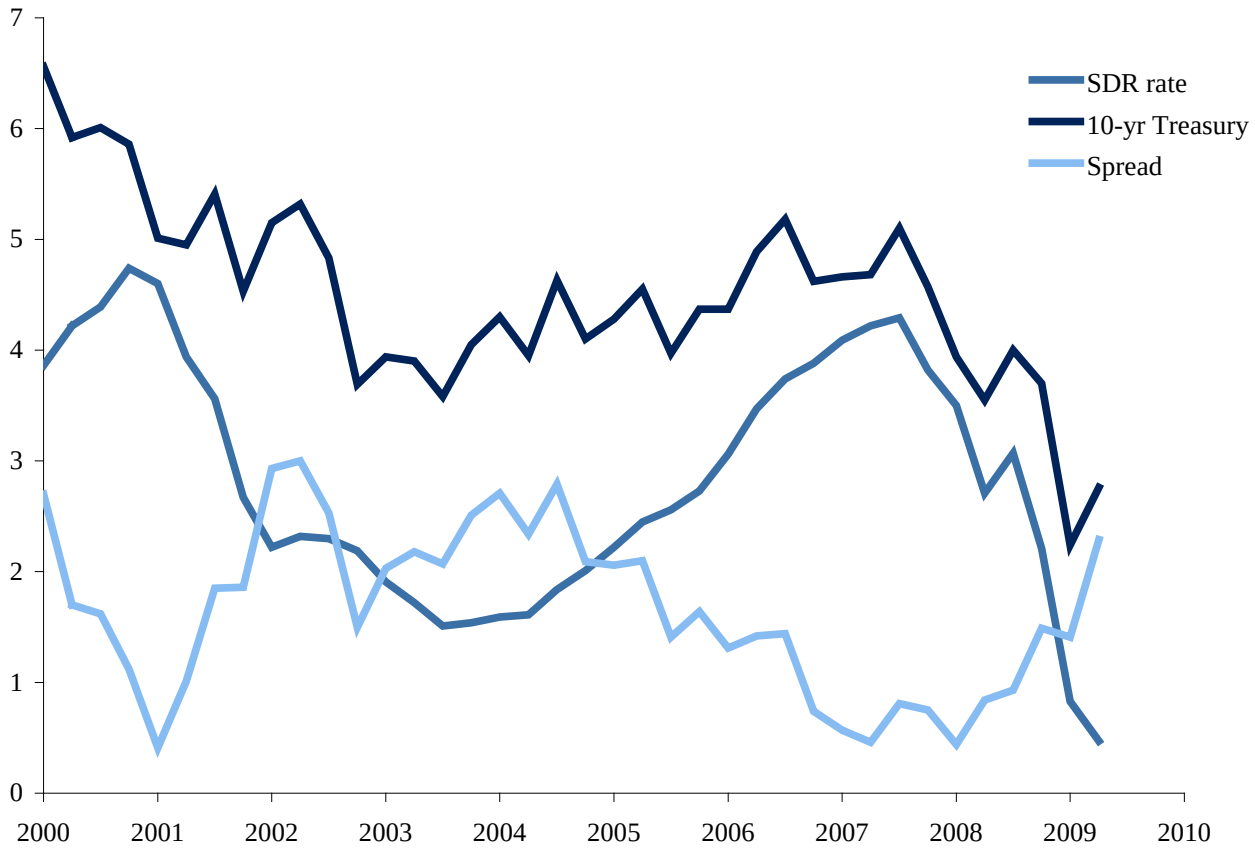
To estimate the cost of such a contribution, we must estimate the difference between the cost to the U.S. Treasury of borrowing for these funds, and the interest received from the IMF.

Figure 1 shows the difference between the interest rate on U.S. Treasuries and the rate paid by the IMF on such funds (the Special Drawing Rights or SDR rate), since 2000. The average difference is 1.7 percentage points, with 10-year Treasuries averaging 4.5 percent and the SDR rate averaging 2.8 percent.

Figure 1
Ten-Year Treasury Note and IMF SDR Rates 2000-2009



Sources: International Monetary Fund and the Federal Reserve.

One approach would be to assume that the spread between the 10-year bond and the SDR rate is the same as over the current decade. This is 1.7 percentage points, as noted above. However, the cost to the U.S. Treasury of borrowing is somewhat less than the 10-year bond rate, because some of its borrowing is short-term. As an approximation of this mix, we can assume that half of the borrowing for this IMF appropriation is borrowed short term. The short-term (three-month Treasury bill) rate over the decade was 2.9 percent. Thus the interest rate for Treasury's borrowing would be an average of the long and short-term rate, or 3.7 percent. (This is an underestimate because the mix of bonds is weighted more toward longer maturities.)

Therefore, the cost of any contribution to the IMF would be the difference between this borrowing cost, 3.7 percent, and the 2.8 percent SDR rate, or 0.9 percent. (See Table 1).

Table 1
Budgetary Cost of Proposed $108 Billion Contribution to the IMF

	2000-09 Average	CBO Long-Run Projection	High Cost Scenario (based on 2000-09 averages)	Low-Cost Scenario (based on CBO long-run projection)
10-year Treasury Note (%)	4.5	5.6		
Treasury Debt Mix Rate (%)			3.7	5.2
3-month Treasury Bill (%)	2.9	4.8		
SDR rate (%)	2.8		2.8	4.6
Cost ($billions)			*26.3*	*16.6*

Source: International Monetary Fund, Congressional Budget Office and the Federal Reserve.

To calculate this sum of these recurring annual costs, we must discount all future annual costs. For a nominal discount rate, we can use the Treasury's cost of borrowing, or 3.7 percent. Thus, by the standard formula for calculating this stream of costs, the cost of this contribution would be 0.9/.037, or 24 percent of the amount contributed.

For the proposed $108 billion contribution, this would be $26.3 billion.

Of course, different estimates may be obtained with different assumptions about future long and short-term interest rates. For example, as a lower bound we can imagine that the spread between the Treasury's borrowing costs and the SDR rate could be as low as the CBO's projected spread between the 10-year bond and the three-month Treasury bill. As shown in Table 1, this is 5.6 minus 4.8 or 0.8 percent. Using the same method, we would get 0.8/.052, or 15.4 percent. For the proposed $108 billion contribution, this would be a cost of $16.6 billion.

Thus we would expect a cost to the U.S. Treasury in the range of $16.6 billion to $26.3 billion.[1] This is much larger than the proposed $5 billion compromise reportedly reached between Congress and the Administration.

Finally, it is worth noting that this analysis does not take into account any risk of IMF default, which the CBO apparently does. Although the IMF has never defaulted before, we have not had a world recession this deep during the lifetime of the institution. If we were to assume the IMF had a higher risk of default than the U.S. Treasury, this would further raise the cost of the IMF contribution.

[1] As noted above, the Treasury mix is probably weighted more towards the long-term bonds than our 50% assumption, so these amounts would be underestimates of the cost.