

EXCHANGE STABILIZATION FUND LOANS TO SOVEREIGN BORROWERS: 1982–2010

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I

INTRODUCTION

This article describes and analyzes the role of U.S. Treasury Department financing provided to sovereign countries from the Mexican debt crisis in August 1982 to 2010.¹ During that period, the Treasury committed to provide fifty financings for twenty sovereign borrowers, totaling about \$54 billion, as well as lines of credit for Mexico, which, when rolled over (and over), totaled about \$53 billion.² Less than one percent of the amount of the financing went to countries outside the Latin American–Caribbean region.³ All such finance was sourced in the Exchange Stabilization Fund (ESF), established in 1934 and since then often described by newspapers as “little known.”⁴

ESF financing was a relatively small, but important part of a broader framework of public-sector financing to distressed governments from such sources as the International Monetary Fund (IMF), the World Bank, the Inter-American Development Bank (IDB), the Bank for International Settlements

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1. The August 1982 date was selected because, according to many observers, mid-August 1982—when Mexico’s financial problems erupted—marked the beginning of the 1980s sovereign debt crisis.

2. See *infra* Table: ESF Credit Arrangements, 1998–2002, showing Exchange Stabilization Fund (ESF) financings, including lines of credit to Mexico, from August 1982 through 2002. Thirteen of the twenty borrowers were Latin American or Caribbean countries. The top borrowers of the fifty noncredit-line loans were Mexico (eleven loans for a total of \$40 billion), Brazil (eight loans and guarantees for a total of \$7.6 billion), and Argentina (seven loans and one guarantee for a total of \$2.4 billion). Since 2002, there have been no ESF financings of the type shown in the table, other than the annual renewals of the North American Framework Agreement (NAFA) and its subsidiary swap lines. No drawdowns have occurred under NAFA since 1995.

3. See *infra* Table: ESF Credit Arrangements, 1982–2002.

4. For a history of the ESF through early 1999, see generally C. RANDALL HENNING, *THE EXCHANGE STABILIZATION FUND: SLUSH MONEY OR WAR CHEST?* (1999).

(BIS), the central banks of a number of countries, and the Federal Reserve.⁵ For the most part, use of the ESF for the purpose of making loans to sovereign borrowers has not been controversial with the public or members of Congress—the major exception to this generalization was the \$20 billion of financing offered to Mexico in 1995.⁶ Use of the ESF has, in fact, been very successful. Sovereign countries have been assisted in financially tight times, the ESF has made a profit (in terms of the difference between interest earned from sovereign borrowers and the Treasury's cost of funds), all accrued interest has been paid, and every penny of principal has been returned. Whether, in the future, loans from the ESF will be as significant and useful in dealing with sovereign debt crises as they were during the past twenty-seven years, of course, remains to be seen. Certain factors have changed, making it less likely for the foreseeable future that the ESF will be used for sovereign loans to the extent it was during the 1980s and 1990s. The ESF has been used for a sovereign loan only once during the twenty-first century—a five-day bridge loan to Uruguay in 2002.⁷ As of the end of fiscal year 2009, the ESF had \$104.8 billion of assets.⁸

II

A BRIEF HISTORY OF THE ESF

The ESF was established pursuant to section 10 of the Gold Reserve Act of 1934 (ESF statute), together with the appropriation of two billion dollars, for the purpose of stabilizing the exchange value of the dollar.⁹ The Secretary of the Treasury, subject to the approval of the President, was given almost exclusive control over the ESF.¹⁰ With the demise of the par-value system in the early 1970s and the adoption of the second amendment of the Articles of Agreement of the International Monetary Fund (IMF) in 1978, the ESF's purpose of stabilizing the exchange value of the dollar was eliminated from the ESF statute. The basic authority of the Secretary was described in the statute in the following terms: "Consistent with the obligations of the Government in the International Monetary Fund on orderly exchange arrangements and a stable system of exchange rates, the Secretary . . . with the approval of the President may deal in gold, foreign exchange, and other instruments of credit and securities."¹¹

5. *See infra* Part VI.D.

6. *See id.*

7. *See infra* Part VII.

8. DEPARTMENT OF THE TREASURY, AUDIT OF THE EXCHANGE STABILIZATION FUND'S FISCAL YEARS 2009 AND 2008 FINANCIAL STATEMENTS (2009), available at http://www.treas.gov/offices/international-affairs/esf/congress_reports.

9. Gold Reserve Act, 31 U.S.C. § 5302 (2006). This section was codified as part of the permanent codification of Title 31 effected in September 1982 pursuant to Public Law 97-258; HENNING, *supra* note 4, at 6–7.

10. 31 U.S.C. § 5302(a).

11. 31 U.S.C. § 5302(b).

At the same time, Congress added a requirement to the ESF statute that no loan could be made from the ESF for a term longer than six months unless “unique or exigent circumstances”¹² were present and the President provided Congress with written notice to that effect. (This restriction, while constituting an added burden in ESF-loan transactions, proved useful in responding to occasional challenges that dealing “in gold, foreign exchange, and other instruments of credit and securities” did not include making “medium term” loans of one to five years.¹³) The text of the ESF statute as it existed on September 13, 1982, upon the codification of Title 31 of the U.S. Code, is exactly the same as it was on September 13, 2009. A Treasury Department table listing the ESF Credit Arrangements from 1982 through 2002 is provided below.

Table: ESF Credit Arrangements, 1982–2002¹⁴

Country	Signing Date	Amount		Description and Utilization				
		Total \$ millions	ESF \$ millions	Multi/Bilateral	Repayment Source	Backup	First Drawn	Fully Repaid
Uruguay	8/4/02	1,466	1,466	B	IMF, IDB, IBRD ¹⁵	No	8/5/02	8/9/02
Mexico	12/. . /00	6,000	3,000	B- Standing			Not Used	Expired 12/. . /01
Mexico	12/. . /99	6,000	3,000	B- Standing			Not Used	Expired 12/. . /00
Mexico	12/. . /98	6,000	3,000	B- Standing			Not Used	Expired 12/. . /99
Brazil (1)	12/. . /98	13,280	5,000	M	Not Applicable	No	12/18/98	4/12/00
Mexico	12/. . /97	6,000	3,000	B- Standing			Not Used	Expired 12/. . /98
Mexico	12/. . /96	6,000	3,000	B- Standing			Not Used	Expired 12/. . /97
Mexico	12/. . /95	6,000	3,000	B- Standing			Not Used	Expired 12/. . /96
Mexico	12/. . /94	6,000	3,000	B- Standing			Not Used	Expired 12/. . /95
Argentina (1)	3/28/95	1,000	250	M	IBRD, IDB		5/4/95	12/1/95
Mexico (2)	2/21/95	20,000	20,000	M	Oil Payments	No	3/14/95	1/16/97
Mexico	1/2/95	3,000	1,500	M	Oil Payments	No	Not Used	Expired 2/21/95
Mexico	12/. . /93	6,000	3,000	B- Standing			Not Used	Expired 12/. . /94

12. 31 U.S.C. § 5302(b). The term in the original version of this provision adopted by Congress in 1976 was “unique or exigent circumstances.” When Congress codified Title 31 of the U. S. Code in 1982, the staff working on codification insisted on changing “exigent” to “emergency,” apparently because they thought “emergency” was clearer than “exigent.” This was done despite the protests of a Treasury lawyer, and caused considerable consternation on the part of at least one Treasury official, both of whom recalled how carefully the term “exigent” had been negotiated in 1976.

13. 31 U.S.C. § 5302(b).

14. This table is the post-1981 portion of a Treasury Department table, which is entitled “ESF Credit Arrangements, 1972–2002,” and is available at <http://www.treasury.gov/resource-center/international/ESF/documents/credits.pdf>.

15. IBRD stands for International Bank for Reconstruction and Development of the World Bank.

Country	Signing Date	Amount		Description and Utilization				
		Total \$ millions	ESF \$ millions	Multi/Bilateral	Repayment Source	Backup	First Drawn	Fully Repaid
Mexico	8/5/94	11,880	3,000	M	TBD	No	Not Used	Expired 12/30/94
Mexico	4/26/94	6,000	3,000	B	Oil Payments	No	1/9/95	1/29/96
Macedonia (1)	2/14/94	30	5	M	Not Applicable	No	Not Used	Expired 2/22/94
Mexico	3/24/94	6,000	3,000	B	TBD	No	Not Used	Expired 4/26/94
Mexico	1/10/94	300	300	B- Standing			Not Used	Expired 4/26/94
Mexico	11/12/93	6,000	3,000	B	TBD	No	Not Used	Expired 3/30/94
Peru	3/9/93	900	470	B	IBRD	No	3/18/93	3/18/93
Panama	1/29/92	143	143	B	IMF, IBRD	No	1/31/92	3/11/92
Mexico	1/12/92	300	300	B- Standing			Not Used	Expired 1/12/94
Romania	3/6/91	300	40	M	IMF, IBRD	No	3/7/91	3/21/91
Honduras	6/28/90	147	82	M	IMF, IBRD	No	6/28/90	11/20/90
Guyana	6/20/90	178	32	M	IMF, IDA, ¹⁶ CDB ¹⁷	No	6/20/90	9/20/90
Hungary	6/19/90	280	20	M	IMF, IBRD	No	6/21/90	9/5/90
Costa Rica	5/18/90	28	28	B	IMF	No	5/21/90	5/21/90
Mexico	3/23/90	1,300	600	M	IMF, IBRD	Oil Payments	3/28/90	7/31/90
Venezuela	3/16/90	400	104	M	IMF, IBRD	No	3/30/90	4/30/90
Mexico	1/12/90	300	300	B- Standing			Not Used	Expired 1/12/92
Bolivia	12/28/89	75	75	B	IMF	No	12/27/89	1/12/90
Poland	12/22/89	500	200	M	IMF	No	12/28/89	2/9/90
Bolivia	9/15/89	100	100	B	IMF	No	9/22/89	12/29/89
Mexico	9/14/89	200	4,125	M	IMF, IBRD	No	9/25/89	2/15/90
Bolivia	7/11/89	100	100	B	IBRD, IDB, Bilateral Loans	No	7/18/89	9/15/89
Venezuela	3/10/89	450	450	B	IMF	No	3/15/89	4/3/89
Argentina	10/19/88	500	265	M	IBRD	No	11/22/88	2/28/89
Mexico	7/25/88	300	300	B- Standing			6/1/88	9/15/88
Brazil	7/19/88	500	250	M	IMF	No	7/29/88	8/26/88
Yugoslavia	6/10/88	250	50	M	IMF, IBRD	No	6/15/88	7/1/88
Argentina	2/23/88	550	550	B	IMF, IBRD	No	2/24/88	5/31/88
Mexico	12/31/87	300	300	B- Standing			See Mexico 7/25/88	Expired 12/31/89
Ecuador	12/3/87	31	31	B	IMF, IBRD	No	12/4/87	1/26/88
Argentina	10/30/87	675	200	M	IMF, IBRD	No	11/13/87	12/30/87
Argentina	3/5/87	500	225	M	IMF	No	3/9/87	7/15/87
Nigeria	10/21/86	250	37	M	IMF, IBRD	Oil Payments	10/31/86	12/11/86
Bolivia	9/16/86	100	100	B	IMF	No	Not Used	Expired 11/14/86

16. IDA stands for International Development Association of the World Bank.

17. CDB stands for Caribbean Development Bank.

Country	Signing Date	Amount		Description and Utilization				
		Total \$ millions	ESF \$ millions	Multi/Bilateral	Repayment Source	Backup	First Drawn	Fully Repaid
Mexico	8/26/86	1,600	273	M	IMF, IBRD	Oil Payments	6/29/86	2/13/87
Ecuador	5/14/86	150	150	B	IMF	No	5/16/86	8/14/86
Mexico	12/31/85	300	300	B- Standing			Not Used	Expired 12/31/87
Argentina	6/18/85	483	150	M	IMF	No	6/19/85	9/30/85
Argentina	12/6/84	500	500	B	IMF	No	12/28/84	1/15/85
Philippines	10/12/84	45	45	B	IMF	No	11/7/84	12/28/84
Argentina	3/30/84	300	300	B	IMF	No	Not Used	Expired 9/15/84
Mexico	12/31/83	300	300	B- Standing			Not Used	Expired 12/31/85
Jamaica	12/23/83	50	50	B	IMF	Bauxite Payments	12/29/83	3/2/84
Yugoslavia (1)	4/22/83	500	75	M	Gold, IMF, IBRD	No	Not Used	Expired 11/15/83
Brazil	2/28/83	400	400	B	IMF	No	2/28/83	3/11/83
Brazil (1)	12/24/82	1,450	500	M	IMF	No	Not Used	Expired 11/30/83
Brazil	12/10/82	250	250	B	IMF	No	12/13/82	1/11/83
Brazil	11/29/82	450	450	B	IMF	No	11/29/82	3/3/83
Brazil	11/17/82	280	280	B	IMF	No	11/18/82	2/1/83
Brazil	10/27/82	500	500	B	IMF	No	10/28/82	12/28/82
Mexico	8/26/82	1,850	600	M	IMF	Oil Payments	9/16/82	8/26/83
Mexico	8/15/82	1,000	1,000	B	Oil Payments	No	8/16/82	8/24/82

(1) These were ESF guarantees of Bank for International Settlements (BIS) credit to the borrowing country. In no case was the ESF guarantee called upon.

(2) Medium-Term Exchange Stabilization Agreement: Not-to-exceed \$20 billion, including any short-term borrowings by Mexico from the ESF, backing by the ESF of any Federal Reserve short-term swap credits to Mexico, and possible ESF guarantees of a securities issue by Mexico.

This table by no means accounts for all uses of the ESF over the years. The ESF has been used for several purposes beyond direct sovereign loans. Until fiscal year 1980, when Congress changed the ESF statute to prohibit the use of the ESF for administrative purposes, its earnings were used to pay the operating expenses of a number of Treasury components, most notably the Office of the Assistant Secretary for International Affairs.¹⁸ It was used many times for intervention in foreign-exchange markets.¹⁹ The ESF has also been used from

18. See Act of Nov. 8, 1978, Pub. L. No. 95-612, 92 Stat. 3091 (terminating Treasury's authority to use the ESF to pay administrative expenses upon the enactment and availability of appropriations for that purpose). Public Law 96-74 appropriated funds for the payment of such expenses, beginning October 1, 1979. Act of Sept. 29, 1979, Pub. L. No. 96-74, 93 Stat. 559. In the 1960s and 1970s, use of the earnings of the ESF to pay such administrative expenses as a house for the Treasury attaché in Tokyo, a rug for the Secretary's office, and extended overseas trips for the Secretary were much more controversial than ESF loans to sovereigns.

19. HENNING, *supra* note 4, at 11-12 (noting that the ESF has not been used for this purpose since September 22, 2000). Henning takes the position that over the years, the most important function of the ESF has been to support foreign-exchange-market intervention. However, this does not appear to have been the case after the demise of the par-value system, particularly since the 1995 ESF response to the

time to time to pay off a sovereign's arrears to an international financial institution (IFI), such as the IMF or World Bank. This has permitted the particular IFI to make a loan to the sovereign without violating its policy of not providing financing to borrowers already in arrears to it. Such ESF financings were paid off the same day, or perhaps even the same hour, by the proceeds of the loan made by the IFI to the sovereign so recently freed of arrears.²⁰

III

ESF LOANS IN GENERAL

This article discusses ESF loans made directly to sovereigns or ESF guarantees of portions of loans to sovereigns made by the Bank for International Settlements (BIS). It focuses particularly on sovereign loans from the ESF that were bridged to financing from the IFIs; almost all the loans made by the ESF in this 1982 through 2009 period fall within this category.²¹

Given the wording of the ESF statute, a checklist of legal points to be covered in any ESF loan arrangement would have included the following:

1. Is the loan consistent with U.S. obligations in the IMF on orderly exchange arrangements and an orderly system of exchange rates?
2. Is the necessary presidential approval in place?
3. Will the term of the loan be six months or more, necessitating a presidential notification to Congress?

Generally, it was quite easy to respond to these three questions. First, an ESF loan to a sovereign was almost always either bridged to an IMF financing or was part of a package that included financing from the IMF. In some cases, the Managing Director of the IMF formally urged that the ESF loan be made. In such circumstances, it appeared obvious that the ESF, in making the loan, was acting consistently with U.S. obligations in the IMF on orderly exchange arrangements and that no further inquiry was needed.

Mexican financial crisis. It might also be noted here that, as a matter of practice, whenever a given amount of funds from the ESF was used for intervention purposes, the Federal Reserve would also intervene with an equal amount of its own funds.

20. The most recent of these same-day operations took place on March 14, 2008, when the ESF was used to make a loan of about \$888 million to clear Liberia's arrears to the IMF. That same day, the IMF Board of Executive Directors approved financial support amounting to about \$952 million for Liberia. Over ninety percent of that amount was drawn down immediately by Liberia and used to repay the United States. *See* Press Release No. 08/52, International Monetary Fund [IMF], IMF Executive Board Fully Restores Liberia's IMF Status, Approves Financial Support Amounting to US\$952 Million and HIPC Decision Point Designation (Mar. 14, 2008), *available at* <http://imf.org/external/np/sec/pr/2008/pr0852.htm>. The Treasury has no comprehensive record of the number of such same-day operations it has financed from the ESF. The Treasury has imposed no interest charges or other fees for these same-day operations because there is no effect on the ESF's income statement when a loan is repaid within the same business day.

21. The loans that did not fall at all within this category were three oil-backed loans to Mexico, two of which were actually drawn. Certain other loans that were backed by receipts from the sale of oil and, in one instance, bauxite ore, were also bridged to loans from one or more IFIs.

Second, over many years, it was determined that President Franklin Roosevelt in 1934 had given very open-ended authorization to Treasury Secretary Morgenthau (and his successors) to operate the ESF. This authorization was relied upon, in most cases, even though evidence of its existence was only indirect. In 2004, a search of the National Archives turned up the actual authorization, which was a copy of a letter from Secretary Morgenthau to the Federal Reserve Bank of New York (FRBNY), authorizing the FRBNY to engage in a wide variety of transactions on behalf of the ESF. The letter bore the signature of President Roosevelt. An accompanying memorandum from Secretary Morgenthau explained that the President had earlier given oral approval and was later requested to sign the copy as written evidence of approval. In 1939, President Roosevelt confirmed this approval by signing another letter from Secretary Morgenthau to the FRBNY.²² These authorizations from the 1930s continue to provide the basic presidential empowerment to the Secretary of the Treasury to engage in ESF operations.

Third, in those few instances in the 1980s and 1990s when a loan agreement specifically provided that the term of the loan was to be six months or more, a presidential notification was, of course, prepared, signed by the President, and sent to Congress at about the time when the agreement was signed. When the agreement provided that the loan was to be paid off unless extended, presidential notification was not done at the time of the signing, but rather when the extension took the term of the loan beyond six months. In short, complying with the above three requirements was relatively straightforward.

Another requirement, imposed since the 1970s for policy rather than legal reasons, was not so easy. For virtually all loans, a strict requirement that there be an “assured source of repayment” was a part of customary ESF policy.²³ This requirement was not found in the ESF statute. The purpose of including this requirement was undoubtedly to minimize the extent to which the ESF was exposed to losses and thus, to give Congress comfort that the Secretary’s ESF authorities were being exercised responsibly. Adhering to this requirement also gave the Treasury a politically acceptable reason for turning down dicey loan requests from sovereigns.

Probably the most important requirement for an ESF loan was that it accomplish the purpose for which it was intended. When using the ESF, the Treasury Department can be described as “an international fire brigade.”²⁴ Of course, a fire brigade must act speedily to combat a blaze. If it acts too slowly or with undue caution, the fire will be out of control, and the brigade will not serve

22. Letter from Henry Morgenthau, Jr., Sec’y of Treasury, approved by Franklin D. Roosevelt, President of the U.S., to the Federal Reserve Bank of New York (July 6, 1939) (on file with *Law and Contemporary Problems*).

23. For criteria determining what was or was not an “assured source of repayment,” see *infra* Part IV.B.2.

24. In his preface to Joseph Kraft’s book, *The Mexican Rescue*, Robert Pringle described the August 1982 Mexican rescue, for which the ESF provided the U.S. financing, as “a classic example of a ‘fire brigade’ exercise.” Robert Pringle, *Preface to JOSEPH KRAFT, THE MEXICAN RESCUE* (1984).

the purpose for which it was created. Most often, the ESF was called upon when a sovereign's financial resources were at the point of exhaustion. An IFI had been called upon to help, and its management had indicated that it was coming, but it was coming at a rather deliberate speed. The house was likely to burn before the IFI arrived. Enter the ESF. Without exception, once an ESF loan transaction was initiated, completing it was an all-consuming process. Late night and weekend hours were the rule, not the exception.

IV

ESSENTIALS OF ESF LOANS

A main advantage of using the ESF to make a bridge loan is that it can be employed faster, a day or two faster when necessary, than any IFI in an emergency situation, holding off the emergency until the IFI resources arrived, which in the case of some outer tranches, took months. Funds from the IFI or IFIs could then be used to repay the ESF. To permit the ESF to be deployed fast in the 1980s, and at least the first few years of the 1990s, it was necessary to minimize documentary and procedural tasks by keeping loan agreements simple and declassified, keeping clearances to a minimum, and standardizing agreements. Despite this simplification, several important items had to be included in the typical ESF loan document:

A. Document and Procedure "Lite"

1. Keep It Simple²⁵

Bridge-loan documents were typically short—five or six single-spaced pages. Obviously, such brevity made them faster to draft, read, and understand. They were exclusively in English, since translations would take time to make and to certify. There were no governing-law or governing-forum clauses. Such clauses not only would have required time to draft, but they could have been the subject of difficult negotiations between the Treasury and the sovereign borrower. In some cases, the sovereign's domestic law could have had limitations concerning what governing-law and governing-forum clauses the parties could agree to. In fact, the agreements, which were between sovereigns, were governed by international law, although they did not specifically say so. Moreover, in every case, the United States had great leverage over the sovereign borrower.²⁶ A sovereign's failure to repay the United States would undoubtedly have destroyed whatever creditworthiness the sovereign had with

25. For a disquisition on the evils of "excessive complexity" in the design, description, and documentation of financial transactions, see Lee C. Buchheit, *Debt Crises and Transaction Complexity*, Address at the Centre for Commercial Law Studies of the Queen Mary University of London School of Law (Feb. 7, 2008).

26. The borrowers invariably viewed themselves as being in an *in extremis* situation when ESF loan documents were being prepared and reviewed. This, plus the simplicity of the documents, may account for borrowers' counsel's never having many comments on draft bridge loan documents.

the IFIs, the financial community, and most sovereign lenders. It is hardly an exaggeration to say that failure to repay an ESF loan would have been an end-of-the-world event for a borrower (and perhaps for the ESF), at least until the default was cured.²⁷

2. Do Not Classify the Documents

Generally, an attempt was made for market and other reasons to keep confidential the fact that the Treasury was negotiating an ESF loan agreement with another country. But no attempt was made to classify the documents: using equipment configured to deal with classified documents slows down the preparation, transmission, and negotiation of documents in any context. The Treasury used its ordinary office equipment in preparing ESF-loan documents and regular communications, such as telephone and telex lines, in discussing and transmitting them. In many phases of making an ESF loan, the Treasury Department relied heavily on the Federal Reserve Board and, particularly, that of New York (FRBNY). Many of the officers and lawyers of these organizations who dealt with ESF loan documents had no security clearances. Also, borrowers often engaged U.S. counsel to review the draft documents; such counsel did not have security clearances. For the Treasury to have balked at making a draft document available to a country's U.S. counsel because the counsel lacked a security clearance would have been highly inappropriate. Finally, typically, each loan document was prepared and negotiated with such speed that a leak would have been unlikely to result in publicity before, or much before, the document was signed. In every case, the Treasury issued a press release when an agreement was signed describing the contents of the agreement, leaving nothing to be hidden from the view of the public. (Despite these efforts, and despite monthly and annual reports to Congress, the ESF purportedly was "little known.")

3. Keep Clearances to a Minimum

Within the Treasury Department, the Secretary, Under Secretary, Assistant Secretary, and several deputies—for the relevant region and for the relevant IFIs—as well as the Office of the General Counsel were directly involved on any given ESF loan agreement. Appropriate White House officials, including the President, were notified of pending ESF transactions. Generally, the Treasury sought no formal clearance from the President as it had his standing approval for most types of ESF transactions. In general, the provision in the ESF statute giving exclusive control over the ESF to the Secretary of the Treasury was relied upon to avoid getting any formal clearance by means of the Office of Management and Budget (OMB) clearance process, or through the State Department's Circular 175 procedure for confirming that "[t]he making of

27. The view implied here about the rationality of borrowers antedated the author's reading an account of Ecuador's recent decision to default on the repayment of several of its bond issues. See Lee C. Buchheit & G. Mitu Gulati, *The Coroner's Inquest*, INT'L FIN. L. REV., Sept. 2009, at 22, 22–25.

treaties and other international agreements by the United States is carried out within constitutional and other legal limitations, with due consideration of the agreement's foreign policy implications, and with appropriate involvement by the State Department."²⁸

4. Standardize Agreements

The ESF-loan agreements were, for the most part, very much alike. This sped up the process of their preparation because all the concerned players on the U.S. side of the transactions were familiar with their terms. Similarly, this facilitated arrangements with borrowers, such as Mexico, Brazil, and Argentina, with whom the ESF entered into several loan agreements over time. Although it is unclear whether borrowers from the ESF ever compared notes, the standardization might have made new borrowers more comfortable. Also, the number of law firms representing sovereign borrowers was very limited.

B. The Typical ESF Loan Document

If the above considerations resulted in ESF transactions being "document and procedure lite," what was essential for inclusion in a typical ESF loan document and the procedure for its negotiation?

1. Loans Structured as Swaps

Virtually all the ESF loan agreements were structured as currency swaps. That is, the Treasury would put up to X dollars in the account of the sovereign borrower at the FRBNY upon the request of the borrower. At the same time, the borrower would place the equivalent amount in its own currency in an account at the borrower's central bank that was designated as an account of the FRBNY, which served as the fiscal agent of the United States. Interest would accrue at the same specified rate on funds in both of the two accounts. The sovereign borrower would typically and promptly withdraw the ESF-sourced funds from its account at the FRBNY, but the fiscal agent funds would not be withdrawn (by either the FRBNY or the Treasury) from the account at the borrower's bank.²⁹ The interest earned by the ESF on the transaction would, at least theoretically, be the interest accruing on its local-currency account at the borrower's bank.

It was thus essential for the agreement to precisely spell out these features:

28. U.S. Department of State, Circular 175 Procedure, *available at* <http://www.state.gov/s/l/treaty/c175> (last visited Sept. 8, 2009). It was the Treasury Department lawyers' view that the Circular 175 procedure did not apply to making ESF-loan agreements because the Secretary of the Treasury had independent authority under the ESF statute to enter into such agreements.

29. *But see infra* Part IV.B.3.

1. The names of the accounts at the FRBNY and the borrower's central bank into which the respective swap proceeds were to be deposited;³⁰
2. The maximum amount of dollars that could be drawn; and
3. For each drawdown, the one exchange rate to be used for entering into the swap, for calculating interest payments on the swap, and for determining the amount required to reverse the swap.

It was essential that the exchange rate be the same for all three facets of the swap to protect the United States against any exchange-rate risk.³¹ Typically, the exchange rate specified for each drawdown was determined by obtaining three quotations of the dollar and foreign-currency exchange rate (by the FRBNY and the foreign central bank) from banks acting in the foreign country's foreign exchange market. Other features that needed to be spelled out included

4. The date by which the swap was to be reversed (that is, the date by which the loan was to be repaid); and
5. The interest rate to be charged.

Most often, this was the Treasury cost of short-term borrowings, particularly when the loan had a short term; but as time went on, a relatively small margin was added.³²

The swap structure was used for several reasons. By 1982, it had already become customary. It could be argued that the Treasury's having the local currency equivalent of the loan in an account at the borrower's bank constituted an assured source of repayment. But the Treasury never felt confident enough about the convertibility or availability of such local currency funds in the event of a borrower's failure to repay, to rely on this "availability" as the sole assured source of repayment. Also, the word "swap" conjures up an image of a monetary transaction between equals and does not have the eleemosynary connotations that the term "loan" brings to mind. There thus may have been political advantages, to both borrowers and to the U.S. government, to using the term "swap" rather than "loan" in ESF transactions.

30. The actual name of the foreign-currency account would be something like "Federal Reserve Bank of New York as Fiscal Agent of the United States, Special Account No. X."

31. For the 1995 Medium-Term Exchange Stabilization Agreement between the United States and Mexico, the exchange rate was re-determined each calendar quarter.

32. For the 1995 Medium-Term Exchange Stabilization Agreement with Mexico, the initial interest rate was the ninety-one-day (thirteen-week) rate of Treasury bills auctioned on the date immediately preceding the first day of each interest period. It was later changed from time to time in order to comply with the Federal Credit Reform Act of 1990. For the 2002 Uruguay loan, the basic interest rate was "the prevailing market rate on the close of the FRBNY Business Day immediately preceding the Value Date for ninety-one-day (thirteen-week) United States Treasury bills, plus an appropriate premium, consistent with financial stability in Uruguay and with the U.S. Credit Reform Act, of not less than six basis points." Exchange Stabilization Agreement, U.S. Dep't Treasury-Cent. Bank Uru.-Republic of Uru., Aug. 4, 2002, at 5.

2. Bridging to Loans from the IFIs

Identifying and providing for an assured source of payment in the agreement was a crucial part of preparing any set of ESF loan documents. Most often the assured source of payment was an anticipated disbursement from the IMF or the World Bank. Indeed, the whole point of the swap was to provide financing before the IMF or the World Bank was in a position to provide financing; and neither institution would be in a position to provide financing until the necessary documents had been prepared and circulated and its Board of Executive Directors had given its approval. That Board would not act until its members and their national authorities had had three weeks to look at the relevant documents. At times, the ESF loan was made several months before the borrower was to meet the conditions for the IMF loan that was to be the source of repayment, or even before the IMF and the borrower had decided on those conditions.

Sometimes an institution's management could not commit the Board to approve the financing. In such instances, the Treasury Department usually obtained a letter of comfort from the head of the institution—the Managing Director in the case of the IMF, or the President in the case of the World Bank. The letter of comfort would state that its writer would submit the financing package to his Board of Executive Directors for approval and would recommend to his Board that the financing be approved and that he knew of no reason why the approval would not be forthcoming. This procedure did not provide an ironclad assurance, but it was a source of additional confidence. In no case did such a comfort letter prove to be misleading; in all cases, the Board of Executive Directors gave its approval.

3. Window Dressing

If, for some reason, the borrower was only at an early stage of negotiations with the relevant IFI, further assurance would be sought. Sometimes, this took the form of what Treasury insiders termed “window dressing.” That is, the borrower would be required to leave any funds drawn from the ESF in an account at the FRBNY until it had successfully completed its financing from the IMF or World Bank or, alternatively, until it was time to repay the ESF when the funds would be used for such repayment. Being in the borrower's account, the funds could be used to beef up the amount of its reported foreign-exchange reserves, but for nothing else.³³

33. Often, the preferred instrument was a nontransferable Treasury certificate of indebtedness or deposit to be held in a custody account of the borrower's central bank at the FRBNY. In the loan agreement with Uruguay, the Treasury did give itself the option of requiring Uruguay to invest the proceeds of its drawings in nontransferable U.S. Treasury Certificates of Deposit that could be redeemed prior to maturity only upon the instruction of the Treasury to the FRBNY.

4. Negative Pledge Clauses

From time to time, the Treasury was tempted to obtain a security interest in certain of the borrower's assets as an assured source of payment. Such an arrangement was out of bounds because of the negative pledge clauses that were standard in all of the Multilateral Development Banks' (MDB) loan agreements and because all the borrowers were parties to such MDB loan agreements. Essentially, these clauses stated that the borrower had not pledged any of its assets so that external debt extended by any other lender would have priority over the loans of the relevant MDB and that, if it did give any lender such a pledge, the relevant MDB would equally and ratably share in that pledge.³⁴ In exceptional circumstances, an MDB might agree to waive the negative pledge clause. Such a waiver would require time for the Executive Board to consider, and it was not certain that the Board would be agreeable to a waiver since, in the event of a default, it would place the ESF ahead of the MDB, and ahead of some of the executive directors' own governments, in the contest for the borrower's limited assets.

Moreover, as a matter of policy, Treasury officials did not want to establish a precedent for sovereign lenders to begin jockeying for priority. Not only would this have complicated the whole borrowing scene, but it would also have complicated the functioning of the Paris Club, where all lenders are expected to take a collective and equal approach to working out settlements with sovereign borrowers.³⁵ Also, the BIS did not have the same compunctions that the Treasury did about taking security interest in the property of borrowers (including gold). Of course, unlike the Treasury, the BIS was not a member of any MDB.

And what was the result of all of this? The ESF was paid all of the principal and interest it was owed on every loan. Those working on ESF loans had the satisfaction of knowing that the transactions had gone smoothly and appeared to be useful to the borrowers who were in tight financial situations. Further, the loans did not cost the United States anything, they appeared to generate

34. See, e.g., International Bank for Reconstruction and Development, The World Bank, *General Conditions for Loans*, at § 6 (July 1, 2005), available at http://siteresources.worldbank.org/INTTOPGENCON/Resources/IBRD_GC_05_Feb08.pdf (containing the World Bank's negative pledge clause).

35. The Paris Club describes itself as an informal group of nineteen official creditors whose role is to find coordinated and sustainable solutions to the payment difficulties experienced by debtor countries. See PARIS CLUB, <http://www.clubdeparis.org/sections/composition/principes/cinq-grands-principes> (last visited May 13, 2010). One of the five key principles of the Paris Club is solidarity, that is, "[a]ll members of the Paris Club agree to act as a group in their dealings with a given debtor country and be sensitive to the effect that the management of their particular claims may have on the claims of the other members." The Five Key Principles, PARIS CLUB, <http://www.clubdeparis.org/sections/composition/principes/cinq-grands-principes> (last visited May 13, 2010). According to one Treasury Department expert, it is inconceivable that Paris Club members in a restructuring would allow a member to receive more favorable treatment than other members by virtue of having a security interest in property of a debtor.

goodwill for the United States, and they helped to shore up the international financial system.

V

THE CASE ACT

After an ESF loan had been signed and made effective, one task remained—fulfilling the requirements of the Case Act.³⁶ Under the Case Act, the text of every international agreement to which the United States was a party must be transmitted by the Secretary of State to Congress within sixty days after entry into effect.³⁷ Since the early ESF loan agreements did not specify the law of a given state as a governing law, they were considered by the Treasury to be international agreements.³⁸ A Treasury lawyer would prepare a short summary to accompany each agreement when it was transmitted to the Office of the Assistant Legal Adviser for Treaty Affairs at the State Department,³⁹ and then to the Committee on Foreign Relations of the Senate and the Committee on International Affairs of the House of Representatives. To the best of the author's knowledge, no Case Act transmission of an ESF loan agreement ever gave rise to any question from anyone on Capitol Hill. Whether such silence is indicative of contentment with the ESF program or a lack of interest is unknown.

VI

VARIATIONS ON THE THEME

A. Guarantees to the BIS

Not all ESF financing for financially troubled sovereigns took the form of plain-vanilla bilateral swaps bridged to IFI disbursements. From time to time, other lenders would be brought in (or the ESF would be brought in, depending on one's perspective), particularly when the amount of the financing needed was more than Treasury officials were comfortable providing from the ESF. In some cases, a number of lenders would have particular interests in a distressed country and, for political reasons, would wish to make financing available. In both types of situations, the potential financiers would turn to the BIS to

36. The Case Act, 1 U.S.C. § 112b(a) (2006).

37. *Id.*

38. Technically, agreements such as the 1995 Medium-Term Exchange Stabilization Agreement with Mexico and the 2002 Swap Agreement with Ecuador are commercial agreements, not international agreements, because, among other things, they have governing-law clauses specifying national law and forum clauses specifying national fora. Commercial agreements to which the United States is a party need not be transmitted to Congress pursuant to the Case Act. But Treasury lawyers chose not to press the point, and sent both agreements to the State Department for transmittal to Congress.

39. International agreements are to be transmitted to the Office of the Assistant Legal Adviser for Treaty Affairs within twenty days of signature. 1 U.S.C. § 112b(a) (2006).

coordinate the financial package and actually provide the financing, with a number of countries guaranteeing all, or at least most, of the borrower's obligations to the BIS.⁴⁰ This occurred five times during the period under review,⁴¹ with the FRBNY guaranteeing the BIS, and then the ESF, in turn, guaranteeing the FRBNY with respect to the agreed-upon share of the BIS financing.

This arrangement was done mainly for reasons of convenience. For seven or eight lenders to coordinate among themselves and to make loans on more or less the same terms would have been very cumbersome and slow.⁴² The coordination problems were at least mitigated by the BIS's making the loan, of course, on one set of terms, and the national financiers' making guarantees available to the BIS, again on one set of terms.

That is not to say that the BIS-centered arrangements were entirely free of coordination issues. For starters, the BIS, which is often described as the central banks' central bank, does not deal with finance ministries. With respect to the first few arrangements with the BIS, the Treasury could speak to the BIS only about loan and guarantee terms through the FRBNY or the Federal Reserve Board. This was cumbersome and often resulted in Treasury officials' not having as good a feel of the transaction as they would have liked to have had. However, in the 1998 arrangement with Brazil, the BIS agreed to work directly with the Treasury. Also, in the early arrangements, even though the Treasury generally made more money on the guarantees than it did on ESF loans, Treasury officials were usually somewhat disgruntled that the BIS charged a higher rate of interest, and made more money, than the Treasury would have done, had it been the lender. For the 1998 arrangement with Brazil, the interest rate charged by the BIS was the rate the Treasury determined should be charged plus a fee tacked on by the BIS.

Finally, the BIS insisted that the documents for the loan transaction remain confidential. Although the negotiation of the guarantee of the BIS was not, and could not have been done using classified systems, the final guarantee agreement was usually classified by the Treasury when it was sent to Capitol Hill to satisfy Case Act requirements to preserve confidentiality.

B. Oil-Payment Arrangements

The bigger and more controversial the transaction, the more concerned Treasury officials were about the terms and conditions of the loan, particularly those relating to an assured source of payment. In the 1986, 1990, 1994, and 1995 ESF loans to Mexico and the 1986 ESF loan to Nigeria, oil payments were

40. In some arrangements, the BIS provided a portion of the financing from its own resources without getting a guarantee with respect to that portion from any country or national central bank.

41. BIS loans partially guaranteed by the ESF were extended to Brazil (two loans), Argentina, Macedonia, and Yugoslavia.

42. The Central Bank of Japan, however, always chose to act in parallel with the BIS rather than join with other central banks in providing the BIS with a guarantee.

required as backing for the borrower's obligations, even though prospective loans from the IMF and World Bank also provided an assured source of payment.⁴³ The arrangements for and the terminology of such backing were carefully crafted to avoid running afoul of the IFIs' negative pledge clauses. Roughly speaking, the transactions were structured so that payments received by the borrower from purchasers of its petroleum were routed through an account of the borrower (or its central bank) in the FRBNY. There was no requirement that a given amount of money be maintained in the account, but, if the borrower defaulted on its obligations, the money flowing through the account could be diverted to pay the Treasury's claims. In none of these arrangements was it ever necessary to divert the oil payments from the foreign borrower's account at the FRBNY.

C. Standing Swap Lines

Virtually since the enactment of the Gold Reserve Act of 1934, the United States and Mexico have had a standing swap line. In the early 1980s, the swap lines were in the amount of \$300 million from each side and expired, and were renewed, every two years.⁴⁴ Under the terms of the swap line, Mexico could request an automatic drawing on half of the line, but the United States had discretion whether to provide funds on the second half of the line in response to Mexico's request. Subsequent to 1982, this swap line was used only once, in August 1988 for a forty-five-day swap for the full amount of the \$300 million.

On April 26, 1994, the ESF–Mexico swap-line arrangement was restructured under a new umbrella, the North American Framework Agreement (NAFA).⁴⁵ It became trilateralized, or perhaps quadrilateralized, with the following separate swap lines: (1) the Treasury (ESF) and Mexico (\$3 billion); (2) FRBNY acting at the direction of the Federal Open Market Committee (FOMC), and Mexico (\$3 billion); (3) FRBNY acting at the direction of the FOMC, and Canada (\$2 billion); and (4) Canada and Mexico (\$1 billion Canadian). Early in 1995, during the crisis involving *tesobonos*—dollar-denominated peso bonds—the amounts of the two ESF and FRBNY swap lines with Mexico were temporarily increased by \$1.5 billion each. The temporary increases were not drawn upon and expired according to their terms on April 3, 1995. NAFA has not been drawn upon since early 1995, but it continues to be faithfully renewed at the end of every December. Like its predecessors, NAFA is, *inter alia*, designed to give confidence to the financial markets that the United States and Canada are prepared to provide support to Mexico should Mexico ever need it.

43. One loan to Jamaica was made on terms that provided for backing with bauxite ore, in addition to a bridge to financing from the World Bank.

44. HENNING, *supra* note 4, at 14.

45. U.S. Treasury Dep't, Joint Statement by the Finance Ministers and Central Bank Governors of Canada, Mexico and the United States (Apr. 26, 1994).

D. Armageddon

Undoubtedly the biggest challenge ever faced by the ESF came in early 1995. Mexico's finances were in desperate straits due to a lack of confidence in its economy as an immediate result of the encashment of *tesobonos*. Firmly committed to helping Mexico in the wake of the 1994 signing of the North American Free Trade Agreement (NAFTA), the Clinton Administration initially sought formal legislative authorization to extend a \$40 billion guarantee to Mexico.⁴⁶ When, in late January, it became doubtful that Congress would give such authorization, the Clinton Administration turned to the ESF as a source of \$20 billion of U.S. financing.⁴⁷ Many members of Congress regarded this as a thumb in the eye and a blatant circumvention of Congress's wishes. These factors, plus the unprecedented size of the transaction, made Treasury lawyers and their clients realize that the documentation would have to be very comprehensive and strong to withstand vigorous attacks from those members of Congress, the press, and the public opposing the transaction.⁴⁸ At the same time, Mexico was running out of dollars, and the transaction had to be negotiated and signed as soon as possible.

There was no question that presidential approval would be sought. No uncertainties or ambiguities could be tolerated. Legal opinions affirming the legality of the transaction were given by the General Counsel of the Treasury and by the Office of the Legal Counsel at the Justice Department.⁴⁹ The backing for the transaction—proceeds from Mexico's sale of oil, oil products, and petrochemicals—was shored up, with letters from all major purchasers of these products specifying where they were going to make payments for the products they purchased.⁵⁰ For the first time, at least since 1982, advice on a point of foreign law, albeit a relatively minor one, was obtained from outside counsel

46. Lawrence H. Summers, *Mexico Fact Sheet* (Jan. 20, 1994).

47. Additional commitments to help Mexico came from the IMF (about \$17.7 billion), BIS (\$10 billion), and the Bank of Canada (\$1 billion Canadian under NAFA). *Id.*

48. Given the relatively large size of the 1995 loan, it was not surprising that it was controversial, even apart from the belief of many members of Congress that it represented a circumvention of congressional will.

49. *The Mexican Peso Crisis, Hearings before the Committee on Banking, Housing and Urban Affairs, United States Senate*, 104th Cong. 435–39 (1995) (statement of Edward S. Knight, Gen. Counsel of the U.S. Dep't of the Treasury). The General Accounting Office examined the transaction and said it did not question the Treasury's authority to enter into it. Legal opinions were also obtained from U.S. counsel for Mexico, counsel for the Mexican Ministry of Finance, and counsel for the Bank of Mexico.

50. Major purchasers, other than Cuba, individually agreed to make payments into an account of Petroleos Mexicanos (Pemex), the Mexican national oil company, at the New York Branch of Swiss Bank Corporation (SBC) in New York. Pemex irrevocably instructed SBC to forward those payments to a Bank of Mexico account at the FRBNY. The Bank of Mexico irrevocably instructed FRBNY to use funds in that account to repay the ESF in the event that Mexico failed to make repayments to the ESF in accordance with the U.S.–Mexico agreements. This arrangement was so highly regarded that it was used as a model for the banking-syndicate loan, which, in 1997, provided Mexico with the funds that it used to repay the ESF.

with respect to an ESF transaction.⁵¹ No waivers of negative pledge clauses were sought from the World Bank, but why the oil-facility structure did not create a lien or other security interest was carefully explained to the World Bank.⁵² A package of four agreements was drafted and negotiated.⁵³ On February 21, 1995, Treasury Secretary Robert Rubin and Finance Minister Guillermo Ortiz signed the documents in the Treasury's Cash Room.

The documents provided for four types of financing from the ESF: (1) short-term (ninety-day) swap transactions (that had been or would be provided under the existing Treasury–Mexico NAFTA swap line as temporarily expanded), (2) backing for short-term Federal Reserve swap transactions (\$4.5 billion of which had been or would be provided under the existing Federal Reserve–Mexico swap line) in an amount not to exceed \$6 billion, (3) medium-term (up to five years) swap transactions, and (4) a guarantee of securities (having maturities of up to ten years) to be issued by Mexico, in a total amount of not more than \$20 billion. It was expected that most of the financing would be in the form of a guarantee of debt securities, the form provided for in the draft legislation that had failed to move through Congress.⁵⁴

As it turned out, no guarantees were provided. There was considerable uncertainty whether the Full Faith and Credit Clause of the U.S. Constitution could stand behind an obligation of the ESF, such as the guarantee to Mexico. Absent full faith and credit backing, it would probably have been necessary to set aside a dollar of the ESF for every dollar of the guarantee in order for Mexico to sell guaranteed securities. Treasury officials were reluctant to tie up a large amount of ESF funds to guarantee a securities issue no larger than the tied-up amount. Lending the money seemed more efficient than using the money as dollar-for-dollar backing for a guarantee. Also, there was a question as to how to select, in a competitive manner, the lender whose loan to Mexico would be backed by the ESF.

51. The cost to the ESF of this advice, from a Mexico City law firm, was somewhat less than \$30,000. The ESF has never used private U.S. counsel with respect to any of its loan or guarantee transactions with sovereign countries. As mentioned above, the assistance of FRBNY and the Federal Reserve Board lawyers has been gratefully received by Treasury lawyers on many occasions when ESF financing arrangements have been made.

52. The General Counsel of the World Bank notified the Treasury that, because no lien or security interest was created, the World Bank would have the right to seek payments out of any Government of Mexico or Bank of Mexico special fund accounts with the FRBNY if Mexico defaulted on any loan or guarantee from the World Bank. A Treasury official orally assured the IMF that the oil facility would not affect the IMF's preferred creditor status and that all creditor countries participating in the financing for Mexico with maturities similar to those offered by the United States would be allowed to share proportionately in the oil facility.

53. These documents were the Framework Agreement, the Medium-Term Exchange Stabilization Agreement, the Guarantee Agreement, and the Oil Proceeds Facility Agreement.

54. See generally U.S. DEP'T OF TREASURY, SEMI-ANNUAL REPORT TO CONGRESS BY THE SECRETARY OF THE TREASURY ON BEHALF OF THE PRESIDENT, PURSUANT TO THE MEXICAN DEBT DISCLOSURE ACT OF 1995 (Dec. 1996).

Altogether, \$13.5 billion was made available to Mexico from ESF.⁵⁵ No particular legal difficulty was encountered in the drawdowns or administration of the loans. Moreover, the loans were repaid ahead of their due dates, largely with money that Mexico was able to raise on the capital markets. The last repayment was made by Mexico on January 16, 1997. The United States earned an estimated \$540 million above its cost of funds on the transaction.⁵⁶ The relatively quick resuscitation of the Mexican economy and the United States' profit reduced long-term criticism of the assistance.

The immediate political aftermath of the Mexican financing was much more challenging than the financial or legal aftermath. The Senate Committee on Banking, Housing, and Urban Development, led by Senator Alphonse D'Amato, strongly objected to the transaction and immediately launched document-discovery demands and held hearings on five different days over a four-and-a-half-month period.⁵⁷ The first hearing took place before the documents for the transaction were even signed. Eventually, two legislative provisions were enacted by Congress constraining the use of the ESF for loans to sovereign borrowers. Due to strenuous efforts by the Treasury, neither provision was, by its terms, permanently effective. Neither provision is in effect today.

VII

RECENT ESF HISTORY

Since the 1995 Mexican transaction, the ESF has been used sparingly for sovereign loan purposes. NAFA continues to be rolled over annually, but none of the bilateral swap arrangements under NAFA have been drawn upon since 1995. In 1995 and 1998, the ESF was used for guarantees of portions of loans by the BIS to Argentina and Brazil, respectively, but neither of these guarantees was called upon.

Notable for their absences were any ESF loans to Asian countries during the 1997 through 1998 Asian Financial Crisis. Extended negotiations took place between the Treasury and the Korean Finance Ministry officials on an ESF loan, but an agreement was never reached. It is probably not possible to assign any one reason for why no loans were made to Asian countries during that period. Perhaps Treasury officials were not as familiar with their Asian counterparts as they were with their Latin American counterparts, and vice-versa. A mutual lack of confidence in the abilities and bona fides of officials in

55. *Id.* This amount includes \$1.5 billion of a short-term Treasury–Mexico swap, \$1.5 billion of short-term Federal Reserve–Mexico swap transactions, and \$10.5 billion of medium-term swap transactions. (Part of the proceeds of one of the medium-term swap transactions was used to repay \$1 billion of the short-term swaps, so that no more than \$12.5 billion of financing was ever outstanding at one time.)

56. *Id.*

57. See generally *The Mexican Peso Crisis, Hearings before the Committee on Banking, Housing and Urban Affairs, United States Senate*, 104th Cong. (1995).

prospective borrowers and the United States may have been a factor. In several cases, available sources of repayment may not have been satisfactory to Treasury officials. In another case, the Treasury may have wanted stronger conditions on how the potential borrower would conduct its financial and economic affairs than the borrower was willing to agree to. Also, Treasury officials may have been reluctant to proceed because they had not yet recovered from the trauma and criticism suffered during the 1995 Mexican debt crisis.

In 2002, the ESF did one of its old-fashioned bridge operations with a Latin American country when it provided a \$1.5 billion loan to Uruguay bridged to financing from the IMF, the World Bank, and the Inter-American Development Bank. The loan was signed on Sunday, August 4, 2002; virtually all of it was drawn on Monday, August 5, to permit the Uruguayan financial system to open; and then it was completely repaid on Friday, August 9.⁵⁸ The wording of the loan agreement was more complex than that used in similar agreements of the 1980s and 1990s. But because much of the wording was adapted from wording of the 1995 Mexican financing documents and because many of the same lawyers on both the Treasury's side and the borrower's side were involved in both transactions, the added complexity did not slow down the drafting and negotiating process very much. The financing generated considerable goodwill in Uruguay, and no ill will (and little notice) on Capitol Hill.⁵⁹ The operation may thus be considered a solid success, coming at the cost of only a few late nights and a lost weekend for a few Treasury officials and lawyers.

More recently—on March 14, 2008—the ESF was used to pay off Liberia's arrears to the IMF in the morning and then was repaid in the afternoon.⁶⁰ This same-day transaction went very smoothly, and was popular with all who knew of it, because of a seemingly universal desire within the administration and on Capitol Hill to help Liberia.⁶¹

It may seem counterintuitive that the ESF was not the source of any lending to sovereigns during the time of the global financial crisis of 2008 when so many countries were experiencing grave financial difficulties. One of a number of possible explanations might be that the Latin American countries were not the hardest hit. Eastern and Central European countries received disproportionately large amounts of loans from the IMF. Also, these countries have received considerable financing from other European countries that took care of their own and protected themselves against banking-sector exposure

58. Press Release PO-3322, U.S. Dep't of the Treasury, Statement of Secretary Paul O'Neill (Aug. 4, 2002).

59. The lack of congressional objection may, in part, have been due to careful Treasury consultation with members of Congress and key staffers prior to proceeding with arrangements for the loan.

60. Press Release PO-3322, U.S. Dep't of the Treasury, Statement of Secretary Paul O'Neill (Aug. 4, 2002).

61. The Liberian operation was also preceded by careful consultation by the Treasury with members of Congress and key staffers.

and the loss of export markets. Thus, the lending action in 2008 and 2009 was centered outside of what might be termed the ESF's region.

VIII

WHITHER SOVEREIGN LENDING BY THE ESF?

Although it may make for good relations with the Bretton Woods institutions and delinquent borrowers from those institutions, there seems to be no strong reason for the ESF to continue to extend the occasional same-day loan like the one it made to Liberia in March 2008. Such loans enable the institutions to maintain the purity of their policy that they not make loans to countries in arrears, but the substance of the same-day loan arrangement seems, in reality, to be contrary to at least the spirit of that policy.

The bridge loan presents a more difficult case. There are times when such loans may be needed and useful. There may be less need for them now, though, than there was in the past. This is mainly because the IMF and World Bank now move faster than they did, say, in the 1980s. In 2009, financing packages were pulled together more quickly. To some extent, improved communications technology can be credited with the IFIs' faster pace in processing loans. Perhaps more important, in September 1995, the same year that the ESF made \$20 billion available to Mexico, the IMF's Executive Board agreed on an emergency financing mechanism (EFM) to strengthen the IMF's ability to respond rapidly in support of members facing a crisis in their external accounts.⁶² Under the EFM, it was expected that documents would be circulated to the Executive Board within about five days after agreement had been reached on a program, and that the Board would be prepared to consider the request for an arrangement as early as forty-eight to seventy-two hours after circulation of the documents. In any event, it is likely that future bridges will be shorter than the bridges of the past. The question will then become at what point bridges need not be bothered with.

On April 17, 2009, the IMF's Executive Board approved the first Flexible Credit Line (FCL), which was for Mexico in the amount of approximately \$47 billion—about the same amount as the total of all ESF noncredit-line financing during the period from August 1982 to the present.⁶³ Under the FCL, which is

62. See International Monetary Fund [IMF], *Summing Up by the Chairman—Emergency Financing Mechanism*, Executive Board Meeting 95/85 (Sept. 12, 1995), available at <http://www.imf.org/external/pubs/ft/sd/index.asp?decision=EBM/95/85>.

63. Press Release No. 09/130, International Monetary Fund [IMF], IMF Executive Board Approves US\$47 Billion Arrangement for Mexico Under the Flexible Credit Line (Apr. 17, 2009), available at <http://www.imf.org/external/np/sec/pr/2009/pr09130.htm>. Poland and Colombia are the other countries that have received FCLs as of the writing of this article. Press Release No. 09/153, International Monetary Fund [IMF], IMF Executive Board Approves US\$20.58 Billion Arrangement for Poland Under the Flexible Credit Line (May 6, 2009), available at <http://www.imf.org/external/np/sec/pr/2009/pr09153.htm>; Press Release No. 09/161, International Monetary Fund [IMF], IMF Executive Board Approves US\$10.5 Billion Arrangement for Colombia Under the Flexible Credit Line (May 11, 2009), available at <http://www.imf.org/external/np/sec/pr/2009/pr09161.htm>.

for crisis-prevention purposes, Mexico has the flexibility to draw on the credit line at any time.⁶⁴ It would appear that, with the FCL in place, there would be little need for the ESF to ride to Mexico's rescue because of either slowness or lack of funds on the IMF's part. Yet in his recent report, which preceded the G-20 (Group of Twenty) Pittsburgh Summit, Prime Minister Gordon Brown, after commending the FCL, said, "[W]e need to bring together regional and bilateral arrangements so that they can play a role alongside the IMF in the provision of financial support within a coherent and consistent framework."⁶⁵ Thus, there does not appear to be universal agreement that, with the recent and very substantial increase in the resources of the IMF, calling upon such national sources as the ESF to supplement those resources will be unneeded.

Several other developments in the past decade or so may make it less likely that the ESF will be called upon for emergency assistance to sovereigns. Several of these developments stemmed from the Asian financial crisis in 1997 through 1998 and maybe, at least in part, from the fact that the ESF was not made available to Asian countries at that time. A number of developing countries have built up large stores of foreign-exchange reserves so that they might be more self-sufficient in times of future crises. The ASEAN (Association of Southeast Asian Nations) countries plus China, Japan, and Korea have united in the Chiang Mai Initiative Multilateralization to provide a pool of short-term liquidity to supplement existing international financial arrangements. The same group of countries is also engaged in the Asian Bond Markets Initiative.⁶⁶ The issuance of local currency bonds in Asian countries and other emerging-market countries (including some in Latin America) should diminish the emergency need for access to foreign currency to cover debt service. During the past year, various European sovereign lenders and financial institutions, sometimes in combination with the IMF, have shown that they are able and willing to take care of financial emergencies in their part of the world.

In the future, loan documentation for even the most straightforward bridge loans (like the one to Uruguay) is likely to be relatively more complicated than the documentation for the 1980s bridge loans. There is no good reason for this other than that once more comprehensive documentation has been used, in order to maintain the appearance of prudence and seriousness, it may not look good to retreat to simpler, less-comprehensive documentation. In any event, with today's computers and e-mail, the longer documentation so far has been a minor inconvenience that does not significantly slow down the process of

64. Press Release No. 09/130, International Monetary Fund [IMF], IMF Executive Board Approves US\$47 Billion Arrangements for Mexico Under the Flexible Credit Line (Apr. 17, 2009), available at <http://www.imf.org/external/np/sec/pr/2009/pr09130.htm>.

65. GORDON BROWN, SUPPORTING GLOBAL GROWTH: A PRELIMINARY REPORT ON THE RESPONSIVENESS AND ADAPTABILITY OF THE INTERNATIONAL FINANCIAL INSTITUTIONS 6 (Sept. 2009), available at <http://www.pittsburghsummit.gov/documents/organization/129851.pdf>.

66. See Jong-Wha Lee & C. Randall Henning, Asia's Recovery and Global Imbalances, Presentations at the Peterson Institute of International Economics (Oct. 14, 2009), available at http://www.piie.com/events/event_detail.cfm?EventID=127.

putting together a bridge-financing document package. Nevertheless, the complexity problem bears watching.

One cloud that is unfortunately already well above the horizon is the Federal Credit Reform Act of 1990 (FCRA).⁶⁷ Briefly stated, the FCRA requires that a subsidy component be computed for each loan at the time it is made. This subsidy is the current value of cash disbursement that, according to probability calculations, is not expected to be returned to the U.S. government from repayments by the borrower.⁶⁸ Generally, appropriations are required for the subsidy costs of loans (but not, of course, for ESF loans). Needless to say, determining the subsidy cost of a sovereign loan is tricky, from both the financial and the political perspectives. Although no appropriation need be sought to pay the subsidy cost of an ESF loan, any subsidy cost will reduce ESF earnings and could attract political attention. Such costs are avoided by requiring the borrower to pay enough interest so that there will not be a subsidy.

The OMB and the Congressional Budget Office (CBO), to a slightly lesser extent, control the implementation of the FCRA. In the course of a number of high-level bureaucratic battles after the FCRA's enactment, the OMB has successfully argued that the last-in-time rule of statutory construction trumps the exclusive control of the ESF granted to the Secretary of the Treasury by the ESF statute. The result is that each use of the ESF for a loan to a sovereign or otherwise must now be vetted by the OMB. Not only is progress slowed, but the Treasury's flexibility in dealing with the sovereign borrower is limited.⁶⁹ Given the ESF's sterling repayment record and the conscientiousness with which Treasury officials impose assured-source-of-payment requirements, the imposition of the FCRA appears unnecessary.

What about mega loans from the ESF that are not bridged to financing from the international financial institutions? The ESF will probably stick with its assured-source-of-repayment policy requirement for such loans, although its agreement to Brazil's maintaining a minimum level of foreign-exchange reserves as the assured source of payment in the context of a 1998 BIS financing may represent a slight loosening of the standard. A deviation from that policy could result in accusations from at least some members of Congress that the Treasury was playing fast and loose with the ESF. But not every country has a resource comparable to Mexico's oil that can be used as backing for a loan or guarantee. In any event, such nonbridge loans would likely be more politically

67. Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, 104 Stat. 1388, *amended by* Pub. L. No. 105-33, 111 Stat. 251 (1995).

68. *See generally* *Testimony Before the Subcomm. on Procurement, Tourism, and Rural Dev. of the Comm. on Small Bus. of the U.S. House of Representatives* (1991) (statement of James L. Blum, Assistant Dir., Budget Analysis Div., Congressional Budget Office).

69. For example, as mentioned above, one of the requirements of section 632 of the Omnibus Appropriations Act of 1996 was that the President certify, prior to each disbursement, that there was no projected cost of the financing provided to Mexico as defined in the Federal Credit Reform Act. The President so certified several times.

controversial than bridge loans and thus, require very careful preparation (including complex documentation) and consultation with Congress.

It is possible that a future ESF multi-billion-dollar guarantee of a sovereign's bond issue would be more politically palatable than a multi-billion-dollar loan. When it dropped the guarantee idea in implementing the 1995 Mexican financing, the Treasury left unresolved a number of issues relating to ESF guarantees. It might work to resolve those questions now, so that in a future financing, it would know whether the guarantee alternative was feasible and how it should be structured. It is possible that such guarantees would enable ESF resources to be stretched further and thereby magnify the effectiveness of the ESF. It may also be possible that securities guarantees would be less controversial and less costly from a budgetary perspective than outright loans.

Consideration also might be given to laying groundwork for using the ESF in some non-Latin American neighborhoods, rather than not engaging in any preparation work until an emergency is upon some unfortunate country. Awkward though it might be, such groundwork might include familiarizing countries with the ESF requirements for its use, particularly the assured-source-of-payment requirement. Treasury officials might also become better acquainted with the officials and government structures of foreign countries that might be candidates for ESF loans in the near future (say, the next two years) and determine how to go about making ESF financing available to that country. Of course, that would have to be done in a manner that would avoid implicitly encouraging requests for ESF support.

On September 19, 2008, the Treasury announced that it was making available as necessary the assets of the ESF for up to \$50 billion to guarantee that the net-asset value of money-market mutual funds wanting to avail themselves of the guarantee (for a fee), would not fall below \$1 per share.⁷⁰ At its peak, the guarantee covered over \$3 trillion of combined fund assets. The guarantee facility ended on September 18, 2009, having suffered no losses and having earned approximately \$1.2 billion in participation fees.⁷¹ During the time the guarantee was in effect, it was not clear how much of the \$50 billion in the ESF would have been available had Treasury officials wanted to make a loan to a sovereign borrower.⁷² One writer, without mentioning the little-known fund,

70. Press Release hp-1147, U.S. Dep't of the Treasury, Treasury Announces Guaranty Program for Money Market Funds (Sept. 19, 2008), available at <http://www.ustreas.gov/press/releases/hp1147.htm>.

71. See Press Release TG-283, U.S. Dep't of the Treasury, Secretary of the Treasury Timothy F. Geithner Written Testimony Before the Congressional Oversight Panel (Sept. 10, 2009), available at <http://www.ustreas.gov/press/releases/tg283.htm>.

72. Under this program, in November 2008, the ESF purchased approximately \$3.6 billion of Government Sponsored Enterprise (GSE) securities from the Reserve Fund's U.S. Government Fund. Upon consummation of this purchase, the GSE securities were classified as held to maturity and were reported as investment securities as of the date of purchase. See OFFICE OF INSPECTOR GEN.: DEP'T OF THE TREASURY, AUDIT OF THE EXCHANGE STABILIZATION FUND'S FISCAL YEARS 2008 AND 2007 FINANCIAL STATEMENTS 26 n.7 (2008). As of September 30, 2010, no GSE securities remained on

said, “America did not plunge into the economic abyss it faced that Thursday night [September 18, 2009]. The bold stroke of guaranteeing the money-market funds stopped the panic and halted withdrawals from the funds.”⁷³ It must be conceded that, but for the existence of the ESF, such a guarantee might not have been possible. Whether the type of fire fought with ESF resources in September 2009 was the same type of fire contemplated when Congress and the President established the ESF in 1934 or changed its mandate in the 1970s is another question.

Members of the Senate Banking Committee were reportedly not pleased with this use of the ESF, but given the seriousness and chaos of the financial crisis, they did not make a fuss (that is, request documents and hold hearings) about it. The only legislation introduced and passed was, at least from certain viewpoints, strongly pro-ESF. It provided that the ESF was not to be used for guarantees of future money-market mutual funds and that any the ESF funds used for the existing money-market mutual-fund-guarantee program would be reimbursed out of Troubled Assets Relief Program (TARP) funds.⁷⁴ Thus, at least as of the time of the writing of this article, Congress can be said to strongly support having the ESF resources available for the more usual ESF purposes.

That said, it should be remembered that the ESF may be one of those things that “you either use . . . or lose” The ESF has been little used over the past decade, other than for the money-market mutual-fund-guarantee program. Its September 30, 2010, balance sheet shows total assets of approximately \$104 billion⁷⁵—in nominal terms almost nine times the total assets shown on the ESF’s end-of-fiscal-year 1982 balance sheet. Much of these resources are Special Drawing Rights (SDRs) held by the ESF. Under the Special Drawing Rights Act, the Secretary of the Treasury is authorized to issue to the Federal Reserve banks certificates against SDRs to the credit of the ESF for the purpose of financing the acquisition of SDRS or financing exchange stabilization operations.⁷⁶ In August and September 2008, the IMF Executive Directors approved allocations of SDRs equivalent to \$250 billion to provide liquidity to the global economic system by supplementing the IMF’s member countries’ foreign-exchange reserves. The share of the United States, and hence the ESF, in these allocations was SDRs equivalent to approximately \$46.7

the ESF books. See OFFICE OF INSPECTOR GEN.: DEP’T OF THE TREASURY, AUDIT OF THE EXCHANGE STABILIZATION FUND’S FISCAL YEARS 2010 AND 2009 FINANCIAL STATEMENTS 22 n.5 (2010), available at <http://www.treas.gov/resource-center/international/ESF/documents/oig11044.pdf>.

73. James B. Stewart, *Eight Days: The Battle to Save the American Financial System*, NEW YORKER, Sept. 21, 2009, at 59.

74. See Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, § 131, 122 Stat. 3765.

75. OFFICE OF INSPECTOR GEN.: DEP’T OF THE TREASURY, AUDIT OF THE EXCHANGE STABILIZATION FUND’S FISCAL YEARS 2010 AND 2009 FINANCIAL STATEMENTS 17 (2010), available at <http://www.treas.gov/resource-center/international/ESF/documents/oig11044.pdf>.

76. Special Drawing Rights Act, Pub. L. No. 90-349, 82 Stat. 188 (1968).

billion.⁷⁷ It is expected that in the future, the ESF will acquire considerable additional SDRs from sovereigns or their central banks in return for dollars. The ESF is expected to get such dollars from the FRBNY by means of the SDR-certificate mechanism. In this way, the ESF will be playing an active role in the global financial system, though not as a lender to sovereigns. Or, from a slightly different perspective, there will be less need for the ESF to make bilateral sovereign loans because of the increased availability of SDRs in the global financial system.

IX

CONCLUSION

However one calculates it, there is a significant amount of money in the ESF, making it a tempting target for champions of other urgent needs. Objectively, how much money should be left more or less dormant, waiting for the next situation where a Western Hemisphere sovereign country gets in financial trouble and international financial institutions and the BIS do not have enough funds, or are too slow, to come to its rescue? The G-20 has endorsed measures to triple the IMF's regular lending capacity from \$250 billion to \$750 billion.⁷⁸ Particularly, in light of FCLs for Mexico and Colombia, in the foreseeable future there would not appear to be a great amount of demand for ESF loans to Latin American sovereigns. It is to be hoped that this situation and outlook continue. At the same time, having a \$100 billion fund on hand itself may increase the political clout of the United States, in general, and the Secretary of the Treasury, in particular.

A question might then be raised as to how big a tank of water the local fire brigade needs, and whether it can also be used for watering gardens behind the firehouse or filling the wading pool for the village youngsters, to justify its being kept available for putting out increasingly rare fires in the neighborhood. Also, to show that the brigade is serious about its duties, it would not hurt for it to have on hand a few maps and guides on how to fight fires beyond the immediate environs of the firehouse and maybe even to practice occasionally, while taking care not to scare the local citizenry.

77. See INTERNATIONAL MONETARY FUND [IMF], GENERAL AND SPECIAL SDR ALLOCATIONS (Sept. 9, 2009), available at <http://www.imf.org/external/np/tre/sdr/proposal/2009/pdf/0709.pdf>.

78. Group of Twenty [G-20], Global Plan for Recovery and Reform: The Communiqué from the London Summit (Apr. 2, 2009), available at <http://www.londonsummit.gov.uk/resources/en/PDF/final-communication>.