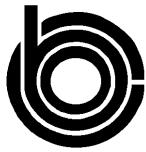

CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

July 21, 2000

S. 2101
International Monetary Stability Act of 2000

As ordered reported by the Senate Committee on Banking, Housing, and Urban Affairs on July 13, 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 qualified dollarized countries in fiscal year 2003.

	2001	2002	2003	2004	2005
CHANGES IN REVENUES[a]					
Estimated Revenues	-4	b	15	29	51

a. 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.

b. 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 2002-1010 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.

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