CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

May 23, 2000

S. 2101
International Monetary Stability Act of 2000

As introduced on February 24, 2000.

SUMMARY

S. 2101 would require the Department of the treasury to make payments to countries that officially adopt the U.S. dollar as their currency. The bill would establish conditions under which the U.S. Treasury would certify countries as being eligible to receive such payments. When a sufficient amount of dollarization occurs, the bill also would require payments to be made to countries that dollarized prior to the bill's passage.

CBO estimates that enacting S. 2101 would increase governmental receipts by $190 million over the 2001-2005 period and by $2,007 million over the 2001-2010 period. In addition, CBO estimates that enacting the bill would increase direct spending by $422 million over the 2001-2005 period and by about $4,012 million over the 2001-2010 period. CBO estimates that implementing the bill's provisions would not significantly affect spending subject to appropriation. Because the bill would affect receipts and direct spending, pay-as-you-go procedures would apply.

The bill contains no intergovernmental mandates 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 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 place into circulation. To the extent that the dollar displaces other currencies around the world, the United States increases these seigniorage earnings while other countries decrease theirs.

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. Department of the Treasury as meeting other requirements specified in the bill. To dollarize, the country would use eligible liquid reserves held by its central bank to purchase dollars from the Federal Reserve. Three months after certification, the Treasury would begin making quarterly payments to the dollarizing country that are equal to 85 percent of the 90-day Treasury bill 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. Each quarter, the payment would be adjusted by the U.S. Consumer Price Index for All Urban Consumers (CPI-U). Countries that dollarized prior to passage of the bill would become eligible for payments (85 percent of the interest earnings on 4 percent of their GDP), when their prospective payments become less than 10 percent of the payments 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 this fiscal year. We further assume that Treasury will begin certifying qualified dollarized countries in fiscal year 2003. The costs of this legislation fall within budget function 800 (general government).

	By Fiscal Year, in Millions of Dollars					
	2000	2001	2002	2003	2004	2005
CHANGES IN REVENUES						
Estimated Revenues	0	-4	4	30	58	102
CHANGES IN DIRECT SPENDING						
Estimated Budget Authority	0	0	0	73	132	217
Estimated Outlays	0	0	0	73	132	217

BASIS OF ESTIMATE

The budgetary effect of S. 2101 cannot be derived 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 a number of countries that might have a significant probability of dollarizing their economies. Ecuador is already in the process of officially dollarizing, and for the purposes of the legislation and cost estimate is classified with the other already-dollarized countries: East Timor, Marshall Islands, Miconesia, Palau, Panama, Turks and Caicos Islands, and the British Virgin Islands.

To calculate the revenue impact of the bill, CBO assumes that currency and bank deposits will remain at their current ratios to GDP in each of the countries identified throughout the 10- year period. 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 the banking system requires cash reserves of 25 percent of the countries' M1 deposits. That figure approximates the combined central bank and commercial bank dollar reserves in Argentina, which requires all bank reserves in U.S. dollars.

To estimate the amount of local currency in circulation in each year in each 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 the purposes of the cost estimate, CBO assumes that the probability that each country would officially dollarize after the enactment of S. 2101 is between 10 percent and 50 percent. All the countries have positive probabilities of dollarizing in the absence of S. 2101. We assume that the probabilities would increase under the legislation by about 50 percent. The estimate is probabilistic; the costs in the estimate are computed by multiplying the countries' currency demand under dollarization by their respective probabilities of dollarizing. These probabilities are phased in slowly over 10 years, from 1 percent of the total probability of dollarizing in 2001 to 100 percent of the total probability in 2010.

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 would also increase currency production and processing costs for the Federal Reserve. CBO bases its estimates of these costs on the existing 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 are similar to those of 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 procedures, CBO expects that countries could not be certified as officially dollarized until 2003. As a result, CBO expects that countries that might have otherwise dollarized in 2001 without S. 2101 would wait until the specifics of the Treasury's certification requirements are reasonably certain. Hence, CBO estimates the bill would reduce dollarization and dollar use in 2001 from the levels assumed in the baseline. Beginning in 2002, CBO estimates the bill would increase dollarization and the revenues from dollarization.

Because of the initial slowing of dollarization described above, CBO estimates that the United States would forgo $4 million in federal revenues in 2001. Since CBO expects gradually increasing probabilities of dollarization, the estimates of increased revenues grow over the 2002-2010 period to reflect the phase-in of those probabilities. We estimate increases in revenues of $4 million in 2002, growing to about $100 million by 2005, and to more than $600 million by 2010.

Outlays

Payments made to countries representing their share of the seigniorage from dollarization would be recorded in the budget as outlays. The estimates of currency in circulation at the time of certification form the basis of this outlay estimate. Countries may not share seigniorage for any currency amounts in excess of the dollar value of local currency in circulation at the time of certification. CBO assumes countries would ensure that they qualify for no less than this maximum. Estimates of the dollar value of local currency at the time of certification are increased each year by CBO's baseline projections of the CPI-U. CBO baseline projections of the 90-day Treasury bill rate are used to calculate the amount to be shared. Because the Treasury would be unable to certify countries before 2003, no outlays would occur until 2003. By 2007, CBO estimates that a sufficient amount of dollarization would occur under the bill to allow already-dollarized countries to qualify to receive payments under the bill's provisions. The outlay cost for those countries is computed based on the projected size of their GDP.

The bill would give the Treasury the authority to pay its expenses without prior appropriation. CBO estimates that these expenses will be less that $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 outlays and governmental receipts that are subject to pay-as-you-go procedures are shown in the following table. 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 outlays	0	0	0	73	132	217	328	511	687	903	1,162
Changes in receipts	0	-4	4	30	58	102	160	236	337	463	621

INTERGOVERNMENTAL AND PRIVATE-SECTOR IMPACT

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

ESTIMATE PREPARED BY:

Federal Costs: Carolyn Lynch and Thomas Woodward
Impact on State, Local, and Tribal Governments: Susan Sieg Tompkins

ESTIMATE APPROVED BY:

Peter H. Fontaine
Deputy Assistant Director for Budget Analysis

G. Thomas Woodward
Assistant Director for Tax Analysis