Dollar in Danger: $100 Billion Line of Credit to IMF Backgrounder

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Summary

In April at the G-20 summit, Barack Obama pledged a $100 billion line of credit to the International Monetary Fund (IMF) as part of a $550 billion global effort to bolster the international bank. The G-20 then approved a new $250 billion general allocation of Special Drawing Rights (SDR)—the bank's reserve asset.

The IMF bank, which delivers aid to developing countries, awaits Congressional approval of the monetary support. Barack Obama stated in his letter to Congress, "We committed to this expansion, and other countries are looking the United States to deliver on our commitment."

Senator Jim DeMint (R-SC) offered an amendment to remove from the Iraq and Afghanistan war supplemental both the $100 billion line of credit to the IMF and the $8 billion increase of the nation's SDR holdings. In the Senate the amendment to remove the provisions failed by a vote of 30-64.

Overall, the legislation, HR 2346, has passed the House at a cost of $96.7 billion and the Senate at $91.3 billion. The IMF provisions were not included in the bill as passed in the House. Since then, House and Senate Democrats have agreed to a $100 billion line of credit to the International Monetary Fund, increasing the role of the SDR. The provisions were agreed upon for the conference version of the bill.

The $100 billion line of credit itself would be the SDR equivalent of $100 billion on the date of the agreement. Currently the U.S. has a $10 billion line of credit to the IMF worth SDR 6.6 billion. The proposal would also increase the U.S. share in the IMF by SDR 4.97 billion at a cost of $8 billion, bringing the total cost to taxpayers to $108 billion, greater than the war supplemental itself.

The IMF provision now proceeds to both the House and Senate for final passage.

The $100 Billion Line of Credit, and $8 Billion More for Special Drawing Rights

The $100 billion line of credit itself would be "the SDR equivalent of $100 billion on the date of the agreement." Currently the U.S. has a $10 billion line of credit to the IMF worth SDR 6.6 billion. If invoked, the $100 billion line of credit would be worth SDR 75.0 billion. Additionally, the provisions would authorize the sale of 13 million ounces gold from the IMF—worth about $11.9 billion.

The proposal would also increase the U.S. share in the IMF by SDR 4.97 billion at a cost of $8 billion "in order to maintain its current voting share and veto power within the organization… Because the Fund's overall quota resources would be expanded to facilitate the realignment of country weights, an increase in the U.S. nominal quota is necessary to keep the U.S. voting share constant at 16.7 percent of total voting power in the Fund," according to the Administration's request. This comes as the other contributors to the fund—like Japan, Britain, France, and China, amongst others—are increasing their shares.

Barack Obama promised a global economic collapse should Congress not intervene. As he stated in his letter, "Many of the developing countries that would benefit from the [$550 billion expansion of IMF lines of credit worldwide] are experiencing severe economic decline and a massive withdrawal of capital. Should the situation become worse, and should the IMF not be in a position to stem the crisis, currencies could collapse. The experience with the Asian financial crisis shows that such a massive failure would be a catalyst for steeper drops in U.S. growth, jobs, and exports."

Controversially, the U.S. Administration and Congress are poised to give the IMF hundreds of billions more dollars to dole out in international aid in a manner that may or may not be effective. Critics of the measure believe that with all that is currently pressing down on American taxpayers that the U.S. would give so much for foreign governments that cannot even manage their own finances. This, on top of the $12.8 trillion that the U.S. has already spent, lent, or committed through the Fed, AIG, Bear Stearns, TARP, "Stimulus," the FDIC, etc., as reported by Bloomberg News.

Background

The G20 proposal for IMF expansion was designed in part to increasingly anchor the currencies of developing economies with the SDR reserve currency. The head of China's central bank, Zhou Xiaochuan, recently wrote that the "SDR has the features and potential to act as a super-sovereign reserve currency."

The G20 summit itself was preceded by both Russia and China proposing replacing the dollar as the world's reserve currency, as reported by Reuters. In March, Treasury Secretary Timothy Geithner supported "[increasing] the use of the IMF's special drawing rights," but backtracked after the dollar started tanking, saying that the U.S. dollar should keep its place as the world's reserve currency.

Since the SDR are in reality simply a fiat currency, they can only become valuable if value is assigned to them. And that is why the Chinese are buying bonds denominated in SDR. According to the vice governor of the People's Bank of China, Hu Xiaolian, "Our contributions to IMF's fund-raising will come in the form of an SDR bond… We are in discussions with the IMF."

Other nations are also purchasing the bonds. Joining China are Russia, India, and Brazil, and are already prepared to purchase their first round of IMF bonds—denominated in SDR. According to the Wall Street Journal, "The IMF is preparing its first bond offering, potentially tailored to Brazil, Russia, India and China. Russia's [$10 billion] offering would equal that of India and would be about a quarter of the $40 billion China is expected to contribute to boost the IMF's resources."

Combined, Russia ($2.261 trillion), Brazil ($1.981 trillion), India ($3.288 trillion), China ($7.916 trillion) have GDP (PPP) of $15.446 trillion compared to the U.S GDP (PPP) of $14.264 trillion. Through transition away from dollar assets, the disparity between the two should be expected to grow, especially if the dollar continues to decline and predicted inflation ensues as U.S. monetary and fiscal stimulus kicks in.

The increased purchase of SDR bonds will not only cause the SDR to take on the features of a supranational currency, it will become one. And China, with the largest cash reserves on hand, could be the chief beneficiary as it stocks up and countries around the world choose to back up their own monetary systems with the new interest-bearing SDR bonds.

Alarmingly, the U.S. actually does not have $100 billion to lend in the IMF. More Treasury bonds will have to be sold overseas—to nations such as China—and to the Fed to create the cash necessary to invest in the international bank as the line of credit is used up through the IMF. Members of both chambers of Congress know that they are proposing to extend a $100 billion line of credit when the nation does not have a $100 billion to lend—necessitating either more borrowing from overseas or printing the money—perhaps aiding to supplant the dollar as the world's reserve currency.

In essence, the U.S. must borrow the money from China, Japan, and Saudi Arabia to invest in the IMF, which as noted would enable China, Russia, India, and Brazil to purchase more SDR bonds and gold from the IMF.

Incrementally, the expansion of the SDR could eventually supplant the dollar as the world's reserve currency.

If China and other nations stop purchasing U.S. treasuries and other bonds all together, the scales could be tipped. Taken together, the SDR expansion poses a danger to U.S. international monetary policy and contains inflation risks. If not countered, the developments could ultimately spark a complete collapse of the dollar and cause unbridled inflation in the U.S.

International dialogue for replacing the dollar is increasing. For example, the dollar recently dropped in trading as the Russian Government once again called for discussion of the idea of a supranational currency, as reported by Bloomberg.

In a June 1st interview with CNBC, Russian President Vladimir Medvedev said "We need some kind of universal means of payment, which could create the basis of a future international financial system. Naturally, because of the crisis in the American economy, attitude to the dollar has also changed." The Russian President will soon be meeting with his counterparts from India, China, and Brazil to discuss his proposals.

China Moving Away from the Dollar

With over $1.5 trillion in dollar-denominated assets of its $1.95 trillion of foreign currency reserves, the Chinese government itself has raised significant concern over the ability of the United States to make good on its word and pay its debts. And that concern is shared—by the American people who are straddled by those debts, by investors worldwide who depend upon a financial system denominated largely in dollars, by U.S. allies who either back their currency with or outrightly use dollars, and on down the line.

In March the Chinese Premier said, "We have lent a huge amount of money to the United States. Of course, we are concerned about the safety of our assets. To be honest, I am definitely a little bit worried. I request the U.S. to maintain its good credit, to honor its promises and to guarantee the safety of China's assets."

According to a recent working paper from the Council on Foreign Relations, "China's $1.5 Trillion Bet," some $768 billion of China's holdings are in U.S. treasuries, $489 billion in agency bonds (Fannie Mae, Freddie Mac, Ginnie Mae, and Federal Home Loan bank), $121 billion of U.S. corporate bonds, $104 billion of U.S. equities, and $41 billion in deposits.

China is also increasingly concerned of the growing national debt of $11.3 trillion and its projected $1.8 trillion budget deficit, and in 2009 is slowing its purchase of U.S. treasuries.

China's fears do not stop there, however. As Americans for Limited Government has extensively reported in its publications, the head of China's central bank, Zhou Xiaochuan, went so far as to advocate replacing the U.S. dollar as the world's reserve currency with the International Monetary Fund's Special Drawing Rights (SDR). He recently wrote that the "SDR has the features and potential to act as a super-sovereign reserve currency."

China is caught in a bind. If it does not purchase U.S. debt, the U.S. resorts to debt monetization—i.e. printing more money to purchase debt—causing dollar depreciation and thus devaluation of their dollar-denominated assets. If it continues to purchase the debt, it exposes itself to ever-increasing risk of critical losses should U.S. debt be downgraded or if the U.S. simply defaults on the debt.

That's why an SDR reserve currency makes so much sense for the Chinese. It would allow them to transition away from dollars into an asset to offset losses should the dollar fall as the world's reserve currency. They would just need buy-in from other nations to do the same and start backing their currencies with the IMF's SDR.

With Russia, Brazil, and India joining China in purchasing IMF bonds denominated in SDR, the new international currency is gaining currency worldwide, enabling China to put its post-dollar agenda into motion.

Conclusion

These shots across the dollar's bow are unmistakable, and come as the American government acquiesces to foreign powers on an ever-widening scale.

Unfortunately, it is no wonder foreign powers want to do business elsewhere. Between a $1.8 trillion deficit that can only be financed by printing more money as China slows its investment in U.S. treasuries, the $3.6 trillion budget that is drowning out private investment into the economy, the $11.3 trillion national debt that may never be paid back, and $104 trillion of unfunded liabilities the nation created for itself through the entitlements Medicare and Social Security, other countries question outright if the U.S. will keep its word.

With Russia, China, India, and Brazil's combined GDP (PPP) of $15.446 trillion compared to the U.S GDP (PPP) of $14.264 trillion, the U.S. should be highly wary of potential runs on dollar assets being prompted by its own policies, particularly in American participation in expanding the role of the SDR currency. Through transition away from dollar assets, the disparity between the two GDP's compared should be expected to grow, favoring the Chinese, Brazilians, Russians, and Indians.

The dollar could also continue its decline and predicted inflation could grow as U.S. monetary and fiscal stimulus kicks in over the next four years. These developments would further devalue dollar assets and incentivize purchase of non-dollar-denominated assets like the SDR.

Therefore, the $100 billion line of credit to the IMF plus the $8 billion purchase of SDR, combined with inflationary monetary and fiscal policies, all pose a considerable danger to the U.S. dollar, economy, and way of life.