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REPORT BY THE U.S.

General Accounting Office

Government Procedures For Buying Some Foreign Currencies

Each year the U.S. Government purchases about $5.5 billion worth of foreign currencies to meet its operating expenses in other countries. GAO found that with few exceptions currencies were being obtained at competitive exchange rates.

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AUGUST 9, 1979

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

INTERNATIONAL DIVISION

B-146749

AGC 00038

The Honorable G. William Miller
The Secretary of the Treasury

Dear Mr. Secretary:

This report discusses arrangements by which the United States acquires some foreign currencies needed for operations in other countries.

Comments from your Department, the Board of Governors of the Federal Reserve System, the Federal Reserve Bank of New York, and the State Department were considered in the report and are included as appendixes I through IV.

Our recommendations to you can be found on pages 8 and 10. As you know, section 236 of the Legislative Reorganization Act of 1970 requires the head of a Federal Agency to submit a written statement on actions taken on our recommendations to the House Committee on Government Operations and the Senate Committee on Governmental Affairs not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report. We would appreciate receiving copies of these statements.

We are sending copies of this report to the Chairman of the Board of Governors of the Federal Reserve System; President, Federal Reserve Bank of New York; Secretaries of Defense and State; and cognizant congressional committees.

Sincerely yours,

J.K. Fasick

J.K. Fasick
Director

REPORT BY THE U.S.
GENERAL ACCOUNTING OFFICE

GOVERNMENT PROCEDURES FOR BUYING SOME FOREIGN CURRENCIES

D I G E S T

Each year the U.S. Government buys about $5.5 billion worth of foreign currencies for operating expenses in other countries which must be paid in local currencies and for nonappropriated fund activities, such as the post exchange system. To determine whether favorable rates were being obtained, GAO reviewed Government procedures for purchasing foreign currencies through the West German Central Bank, the Dai-Ichi Kangyo Bank in Tokyo, the State Department finance centers in Paris and Bangkok, and the Federal Reserve Bank of New York. With few exceptions, currencies were being obtained at competitive exchange rates and existing arrangements were effective.

It is probable that the State Department could obtain somewhat more favorable rates for Japanese yen if its requirements were purchased under the same arrangements as those prevailing for Defense Department foreign operations.

Although GAO did not comprehensively review the purchase of currencies with official fixed rates of exchange in relation to the dollar, some instances were noted where the State Department was buying such currencies at rates less favorable than the official rate.

At GAO's suggestion, arrangements were made for State to buy Korean won at the official exchange rate and a review will be made of arrangements for buying other currencies with fixed exchange rates to ascertain that the U.S. Government receives the most advantageous rates available.

COORDINATION OF FOREIGN CURRENCY PURCHASES WITH MONETARY INTERVENTION OPERATIONS

GAO questioned whether the U.S. Government could acquire the foreign currency needed to meet operating expenses in other countries at more favorable rates of exchange and whether foreign exchange intervention operations could be better coordinated if selected currency needs (e.g. German marks and Japanese yen) were obtained through the Federal Reserve Bank of New York. From the standpoint of obtaining foreign currencies at competitive rates and servicing Defense needs, there seemed to be no particular advantage in doing this.

Information available to GAO concerning Treasury and Federal Reserve foreign exchange operations to counter periodic disorderly monetary market conditions, such as speculative pressures, appeared to support the desirability of coordinating the large annual Defense purchases ($2.6 billion in marks and $1.0 billion in yen) with foreign exchange intervention operations. For other than such selected currencies, it did not seem advantageous, for monetary intervention purposes, to have Government agencies obtain their foreign currency needs through the Federal Reserve Bank.

GAO proposed that Treasury and the Federal Reserve use the Federal Reserve Bank of New York to coordinate Government foreign currency purchases, especially German marks and Japanese yen, with monetary intervention operations. Since GAO neither has nor seeks authority to review U.S. international monetary policies and interventions, it recognized that the merits of this proposal would need to be assessed by the responsible agencies.

In commenting on GAO's proposal, the Board and the Bank both said that, although they have the capabilities to do so, there appeared to be no special benefit in coordinating foreign currency purchases with intervention transactions and they would assume the function only if requested to do so. Treasury concurred with this view, and GAO has, therefore, withdrawn its proposal.

C o n t e n t s

Foreign exchange rate
Foreign currency
Foreign currency exchange
Monetary policy
Procedures of purchasing [illegible]

CHAPTER 1

U.S. GOVERNMENT PROCEDURES

FOR PURCHASING FOREIGN CURRENCIES

The United States buys foreign currencies for operating expenses in other countries which must be paid in local currencies, including salaries of foreign nationals, contractual services, rents, supplies and equipment, and travel. These expenses are financed from appropriated funds and account for about half of the $5.5 billion worth of foreign currency purchased each year. The remainder of the foreign currency purchased is used for such nonappropriated fund activities as the post exchange system and for sales to U.S. military, civilian, and contractor personnel in exchange for dollars.

Department of the Treasury guidance to the Departments of Defense and State for purchasing foreign currencies requires that they avoid speculation through obtaining foreign currencies only when payments are due.

We made this review to determine whether the Government obtained favorable rates in purchasing foreign currencies. We found that, with few exceptions, the U.S. Government was buying foreign currencies at competitive rates. We believe, however, that savings would result if all Government requirements for Japanese yen were obtained under the arrangements that provide the most beneficial exchange rates. Also, procedures should be reviewed for insuring that foreign currencies with official fixed conversion rates in relation to dollars are purchased at rates no less favorable than official rates.

TYPES OF TRANSACTIONS

In a foreign exchange transaction, each party promises to pay a certain amount of currency to the other on an agreed date. The most common type of transaction is called a "spot" transaction, whereby the agreed payment date (or "value date" as it is known) customarily is 2 business days following the transaction. This allows time for the parties to send instructions to debit and credit bank accounts at different locations. Banks often trade for "next day" value, whereby payment is made one business day after the transaction. Banks also can trade for "cash", whereby payment is made on the same day.

Another type of transaction is the "forward" transaction, under which the value date can be a few days, months, or even years in rare cases. The exchange rate is fixed at the time of the transaction, but no money changes hands until the value date. Usually the exchange rate for a forward transaction will differ from that for a spot transaction.

The method of settlement for dollars in a foreign exchange transaction usually differs from settlement for foreign currency. Settlement in foreign currency is made in "immediately available funds;" that is, the recipient can use the funds on the value date of the transaction. Settlement in dollars is made in clearinghouse funds, which are not available for use until the first business day after the value date. By custom, exchange rates are quoted in clearinghouse funds. If the seller of dollars settles in immediately available funds, it receives a slightly better rate to compensate for the loss of one day's funds.

GERMAN MARKS

In fiscal year 1978, marks valued at $2.6 billion were purchased, all except $46 million of it for the Defense Department. The $46 million was purchased by the State Department for civilian agency needs.

Defense

Since the flexible exchange rate system was initiated in 1973, Defense has purchased marks valued at $11.5 billion from the West German Central Bank (Bundesbank).

The Army and the Air Force buy all their marks from the Bundesbank through the American Express Company in Frankfurt at the 1 p.m. fixing rate set by the major commercial West German banks and the Bundesbank. The Army and the Air Force have until 11 a.m. each day to buy at the fixing rate for the previous day. Settlement is made in immediately available funds, and Defense gets use of the marks and the Bundesbank gets use of the dollars on the day of the purchase.

Defense arrangements for purchasing marks date back to a January 1952 agreement between Headquarters, U.S. Army, Europe, and the Bundesbank's predecessor. A July 1961 agreement replaced the 1952 agreement. The July 1961 agreement was amended in May 1971 and April 1972. Also, an April 1978 letter from the Bundesbank to the Army refers to a March 1973 agreement, apparently verbal between Bundesbank and

Army officials, to use the last known official fixing rate quoted on the Frankfurt currency exchange for making dollar/mark conversions.

The 1961 agreement provides that either party may cancel the agreement by giving 90 days notice. The later agreements do not change this provision.

State

The State Department's Regional Finance Data Processing Center in Paris purchases marks from the Bundesbank through the American Express Company at the fixing rate or from commercial banks at a rate obtained by canvassing European foreign exchange markets.

The Paris Finance Center buys foreign currencies for civilian agencies in 90 countries throughout Europe, Africa, and the Near East; it also buys the Air Force's requirements for pound sterling. From November 1976 to October 1977, the Center bought $553 million worth of foreign currencies, $462 million of which was in floating currencies. Currency is purchased through spot transactions, with value dates of 2 business days following the transactions, and settlement is in clearinghouse funds.

During October 1977 through March 1978 and August through November 1978, the Finance Center made 98 purchases of marks totaling $43.6 million. In 30 cases, or 31 percent, 1/ it obtained a better rate on the open market, saving $64,276.

AGENCY COMMENTS

We discussed the Defense Department's arrangements for purchasing marks with Defense and Treasury personnel. We noted that the existing agreement does not seem to require Defense to buy all of its marks from the Bundesbank and asked whether it would be appropriate to buy marks in the open market when better rates were available. U.S. Army staff in Europe said that, regardless of the written agreements, there is a gentlemen's agreement that Defense will buy all of its marks from the Bundesbank. They said that the gentlemen's

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1/If the Finance Center settled in immediately available funds, we estimated that it would have obtained better rates in 36 cases, or 37 percent of the time.

agreement was made at the time of the first written agreement in 1952 and has been verbally passed on among Army officials in Europe.

Treasury officials said that the present system has provided competitive rates over the years and Defense purchases have not disrupted the market because the dollars are resold in the market gradually by the Bundesbank. It was Treasury's view that it could be unfair to expect the Bundesbank to hold an exchange rate for such large military purchases for a 22-hour period while Defense sought more favorable rates.

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Defense staff-level personnel said that the present arrangement assures the availability of marks when and where needed. According to an official of the Federal Reserve Bank, however, the Federal Reserve Bank could also make suitable delivery arrangements, as follows.

> "Purchases and sales of foreign exchange would be executed upon receipt of properly authenticated instructions. The instructions should indicate the currency involved, the delivery date for the foreign currency, the amount to be purchased, or sold, the institution to which the foreign currency should be paid and for whose account. Orders received by 8:00 a.m. in New York can normally be excuted for delivery on that day. Any instructions received later will need to have a value date (delivery date) of at least the following day. Following execution of any order, we will notify the customer by telephone, or by wire, and subsequently by mail, of the rate at which the order was executed, the foreign currency, the value date, and the U.S. dollar equivalent of the transaction."

JAPANESE YEN

In calendar year 1978, the U.S. Government purchased yen at a cost of $989 million, $969 million for military needs and $20 million for civilian agencies.

Defense

The Defense Department, under a contract negotiated by the Treasury Department, currently purchases all of its requirements for yen from the Dai-Ichi Kangyo Bank in Tokyo. The major commercial Japanese banks and the Bank of Japan set a fixing rate at 10 a.m. each business day. Yen are purchased at the fixing rate plus a 16 sen premium. For example, if the fixing rate for the day of purchase is 190.80 yen to $1, Defense buys at the rate of 190.96 yen to $1. The order is placed in the morning, before the fixing rate is set, for "next day" value; that is settlement is made on the first business day following the transaction. Defense and the Dai-Ichi Kangyo Bank both receive immediately available funds. Yen are purchased almost every business day.

Through September 1977, the United States purchased yen for military needs from the Bank of Japan. This arrangement was terminated because the Japanese Central Bank was adding the dollars to its reserves instead of reselling the dollars in the market. The U.S. demand for yen was not, therefore, permitted to have an effect on the market. At the suggestion and agreement of the Japanese authorities, the United States then instituted yen purchases in the market.

Effective October 1, 1977, the Treasury Department, in coordination with Defense, agreed to purchase military requirements for yen from the Bankers Trust Company, New York. Bankers Trust agreed to sell yen to the United States at 2 sen above the 10 a.m. fixing rate through February 19, 1978. Treasury awarded the contract to Bankers Trust after considering competitive proposals solicited from 13 American Banks.

Since February 20, 1978, Treasury has awarded two contracts to the Dai-Ichi Kangyo Bank at 16 sen above the 10 a.m. fixing rate. The first contract was awarded after receiving proposals submitted by 11 American and 8 Japanese banks. The second contract runs through September 30, 1979, and was awarded after reviewing proposals from 8 American and 8 Japanese banks.

Before the first contract was awarded to the Dai-Ichi Kangyo Bank, Treasury, Defense, and State considered alternative ways to buy yen for military needs at favorable exchange rates, including:

1. Having State's Regional Finance Center in Bangkok canvass worldwide markets for favorable exchange rates.

2. Having Defense canvass the Tokyo market for favorable exchange rates.

3. Buying yen under contract from one bank after soliciting proposals from Japanese and American banks.

Treasury and State personnel concluded that the Bangkok Finance Center did not have the communications capability to canvass foreign exchange markets for the best rates. The Finance Center had recently installed a telex machine to solicit quotes but, due to the time required to obtain quotes by telex, the agencies questioned whether a bank would hold its quote while other banks were contacted. It was concluded that improved telephone communications were needed to obtain favorable rates.

Defense staff in Japan said that in order to canvass the Tokyo market for exchange rates, two additional employees would be required and that it would take at least 6 months to train these employees. Treasury said that canvassing the market could be simplified through giving a finance officer a list of banks to telephone for quotes and placing a Defense-wide order with the bank offering the best rate; bilingual personnel would be needed to call the banks.

After considering the first two alternatives, Treasury and Defense decided on the third alternative. Competitive proposals were solicited from Japanese and American banks and the Dai-Ichi Kangyo Bank was awarded the contract.

State

The State Department, through its Bangkok Regional Finance Center, purchases yen after a limited canvassing of the foreign exchange market in Tokyo.

The Finance Center was established in 1973 to provide payroll, disbursing, and accounting services for U.S. Government agencies in South Asia and East Asia and the Pacific areas. State selected Bangkok as the site for the Center because a Navy computer at that location became available to assist in operations. From January 1 to October 6, 1978, the Center purchased $42.2 million worth of foreign currencies, $33.6 million of which was in floating currencies. Purchases are made through spot transactions with value dates one business day after the transaction, and settlement is in immediately available funds.

In 1977, the Bangkok Regional Finance Center assumed responsibility for civilian agency disbursing operations in Japan and started purchasing yen for these agencies. Prior to 1977, yen had been purchased through the Regional Disbursing Office in Manila.

An official in the Bangkok Finance Center told us that the communications system in Thailand would have to be improved before foreign exchange markets could be adequately canvassed for favorable rates; there are not enough telephone lines and it takes as long as one hour to place an outgoing international call.

In buying yen, the Finance Center uses a telex machine to solicit quotes from commercial banks in Tokyo; only two banks are contacted because it takes about 15 minutes to obtain each quote. Officials said that it would be unrealistic to contact more than two banks because in a volatile market a bank will not hold its quote very long; sometimes the first bank will not hold its quote until the Center obtains a second quote.

Officials said that one employee now handles foreign currency purchases and that a second employee and a second telex machine would improve the Center's capability for canvassing foreign exchange markets.

From January 1 to October 6, 1978, the Finance Center made 15 purchases of yen costing $16.2 million. We compared the rates for these purchases with rates available to Defense under contracts with Bankers Trust Company and the Dai-Ichi Kangyo Bank. For 8 of the 15 purchases, the Defense contract rates were better than the rates obtained by the Bangkok Finance Center. The Center incurred overall costs of $6,606 more than the 15 purchases would have cost under the current Defense arrangement.

As shown in chapter 2, the exchange rates obtained under the current Defense arrangements were competitive for a selected period of time with exchange rates that might have been obtained by the Federal Reserve Bank of New York. Considering the Bangkok Finance Center's limited communications capability at the time of our review, we concluded that somewhat more favorable rates for yen probably would be obtained by State under whatever arrangement prevails for obtaining yen for Defense operations.

We proposed that Treasury, in cooperation with State, arrange to buy yen for State needs in the same manner as Defense buys its requirements.

AGENCY COMMENTS

Treasury stated that the communications capability of the Bangkok Regional Finance Center had improved since the time of our review. A new trunkline has expanded the Center's telex capabilities, and it now takes only 3 to 4 minutes to obtain a quote over the telex lines in Bangkok.

State said that it was coordinating with Treasury to decide the most suitable methods for purchasing yen to meet U.S. Government operating needs. (See app. IV.)

State said that the contract with the Dai-Ichi Kangyo Bank probably would be renewed at the beginning of fiscal year 1980 and provide for acquisition of all U.S. Government yen needs unless there was a more favorable offer from a competitive banking institution.

RECOMMENDATION

We recommend that the Secretary of the Treasury, in cooperation with the Secretaries of State and Defense, obtain all requirements for yen through the method that provides the more beneficial exchange rates.

CANADIAN DOLLARS

In fiscal year 1977, the U.S. Government purchased $164 million worth of Canadian dollars for military needs through the Federal Reserve Bank of New York. The Bank made these purchases on the basis of instructions from the Treasury Department, which generally asked the Bank to enter into a forward transaction. Settlement is in immediately available funds.

The Federal Reserve Bank has direct telephone lines to 30 commercial banks operating in the North American foreign exchange markets and keeps up to date on exchange rates for the Canadian dollar and other major currencies by contacting these banks periodically during the day. It also uses Reuters market information service to monitor exchange rate movements. Reuters provides current information on a video screen about exchange rates quoted by various banks.

The Federal Reserve Bank said that the quotes obtained by its traders at several points during the day merely indicate market levels at the moment they are collected and constantly fluctuate. In practice, according to the Bank, when a trader is seeking a price for Canadian currency, he monitors the rate fluctuations and obtains more than one quote when suggested by market conditions. A trader determines whether or not to accept a rate on the basis of his experience and judgement of the current trend in the price, the amount of the transaction, the depth of the market, and his evaluation of other market conditions.

CONTROLLED CURRENCIES

We did not comprehensively review purchases of currencies with official fixed rates of exchange in relation to the dollar; however, we noted some instances in which the State Department was buying these nonflexible currencies at rates less favorable than the official rates.

Korean won

In fiscal year 1977, the U.S. Government purchased $248.8 million worth of Korean won, $247.4 million for military needs and $1.4 million for civilian purposes. These purchases were made only after won available from debt payments by the Korean Government was depleted.

Defense

Since 1973, Defense has purchased won from the privately owned Cho Heung Bank at the rate of 484 to the dollar. This is the official exchange rate fixed by the Korean Central Bank.

Defense selected Cho Heung as its supplier because it has the capability to deliver won to the various finance offices in Korea through its branch system. U.S. banks do not have branches throughout Korea, and delivery costs for American banks would be expensive.

State

The Bangkok Finance Center purchases the won needed for civilian purposes primarily from Citibank, the U.S. depository in Korea, because Citibank routinely offers the best available rate. From January to July 1978, the exchange rate ranged from 481.45 to 483 won to the dollar.

Although purchases of won for civilian agency needs are not nearly as substantial as those for military needs, there would still be some savings if the Bangkok Finance Center could make the civilian purchases at the same rate available for military purchases.

In October 1978, we asked officials in the Bangkok Finance Center whether arrangements could be made to buy won for civilian purposes at the more favorable exchange rate available to the military, and they agreed to inquire about the matter. In February 1979, Treasury officials advised us that such arrangements had been completed and a civilian purchase had been made in December 1978 at the rate of 484 won to the dollar.

Other controlled currencies

State, through its Paris and Bangkok Finance Centers, purchases other controlled currencies from banks in the the foreign countries which also act as depositories for the U.S. Government. The banks advise the Centers of the exchange rate and the foreign currency amounts credited to the U.S. account. The Centers' records do not show whether the exchange rates at which U.S. accounts were credited are the official rates established by the governments of the countries involved.

According to financial statistics issued by the International Monetary Fund, the U.S. account was not credited at the official rate for one purchase of a controlled currency. On December 4, 1978, the Paris Finance Center purchased $100,000 worth of Yemen rials at the rate of 4.535 rials to the dollar from the Yemen Bank for Reconstruction and Development. International Monetary Fund statistics showed that the exchange rate set by the Central Bank of Yemen for that date was 4.562 rials to the dollar. Had the purchase been made at the official rate, the Center would have saved $603. This amount could represent payment of a service charge to the seller bank, which might have been avoided by direct purchase from the Yemen Central Bank.

RECOMMENDATION

We recommend that the Secretary of the Treasury, in cooperation with the Secretary of State, review arrangements for insuring that foreign currencies with official fixed conversion rates in relation to the dollar be purchased at rates no less favorable than official rates or determine reasons why this may not be done.

AGENCY COMMENTS

Treasury agreed with our recommendation. It said that, although all currencies cannot be obtained at the official rates since many are adjusted for bank conversion fees, a review will be made to ascertain that the U.S. Government is buying these currencies at the most advantageous rates available.

State said that it will cooperate with Treasury in this review. It said that commercial sales of controlled currencies are usually carried out through the commercial banking system in the countries involved and that insofar as the rates reflect bank charges they will not be the same as the official fixed rates.

CHAPTER 2

COORDINATION OF FOREIGN CURRENCY

PURCHASES WITH MONETARY INTERVENTION OPERATIONS

We questioned whether the U.S. Government could acquire the foreign currency needed to meet operating expenses in other countries at more favorable rates of exchange and whether foreign currency intervention operations could be better coordinated if selected currency needs (e.g. German marks and Japanese yen) were obtained through the Federal Reserve Bank of New York.

INTERVENTION OPERATIONS

The long-term value of the dollar in relation to foreign currencies depends on such economic factors as inflation and productivity rates, balance of trade, energy policy, budget deficit, and other monetary and fiscal policies. However, the Federal Reserve Bank of New York, acting under coordinated instructions from the Department of Treasury and the Federal Reserve Board, conducts intervention operations to counter disorderly monetary market conditions under the flexible rate system. If the Bank wants to stop the dollar from declining in value, it intervenes by selling another currency, such as German marks, in exchange for dollars to increase the demand for dollars and stabilize or improve its value. If the Bank wants to prevent a rapid increase in the dollar's value, it intervenes by selling dollars in exchange for a foreign currency. The Bank uses various intervention techniques depending upon market conditions and tactical objectives.

On November 1, 1978, the United States announced a new program to counter the rapid, disruptive decline in the dollar which was not justified by underlying economic factors. This program increased the amount of foreign currency available for U.S. intervention, including $29.8 billion in short-term reciprocal credit lines (swap network) between foreign central banks and the Federal Reserve Bank of New York. The swaps consist of simultaneous spot and forward currency transactions between these monetary authorities at the same rate of exchange. Under this arrangement, the Federal Reserve Bank buys a foreign currency against dollars, with a commitment to reverse the transaction at or before a fixed date, usually 3 months hence, at the same rate of exchange. Also $10 billion equivalent would be obtained from issuing foreign currency denominated securities, $3 billion from drawing on the U.S. reserve position with the International Monetary Fund, and $2 billion equivalent from sales of special drawing rights to mobilize additional balances of German marks, Japanese yen, and Swiss francs. Other resources of the Exchange Stabilization Fund are also available for monetary intervention purposes.

The Federal Reserve Bank said that from August 1978 to January 1979, the U.S. intervention sales of foreign currencies totaled $9.3 billion. In German marks, sales over this 6-months amounted to $8.1 billion, of which $4.9 billion was for the Federal Reserve and $3.2 billion for the Treasury. In Swiss francs, the Federal Reserve sold a total of $1.0 billion. Sales of Japanese yen totaled $207 million, of which $161 million was for the Federal Reserve and $46 million for the Treasury.

ADVANTAGES AND DISADVANTAGES OF COORDINATION

An official of the Federal Reserve Bank of New York provided us with information suggesting that, on balance, it may be advantageous to U.S. interests for the Bank to purchase selected foreign currencies for Government operating needs. The official's main reservations concerned delivery of funds if other than major currencies were involved.

Factors favoring the arrangement in the official's view include:

1. The Bank's professional staff has an intimate knowledge of the workings of the currency markets and the technical details of foreign exchange trading; it is in constant contact with the market, following rate movements on a minute-to-minute basis.

2. The Bank deals actively in the market; in addition to official intervention activities, it deals as agent for official foreign accounts and in 1978 dealt in about 50 different currencies spot and in a variety of forward maturities.

3. The Bank has direct telephone lines to 30 commercial banks operating in the North American foreign exchange markets; the prestige of dealing with the U.S. Central Bank and the large volume of business it generates

prompts these banks to bid aggressively for its business and results in obtaining the best prices available in the market.

4. The Bank has daily telephone contact with major European central banks and maintains cable communications with most others; at times, these relationships enable the Bank to purchase or sell substantial amounts of currency at market rates directly from another central bank, thus avoiding chasing the rate while executing the transaction in the market.

5. Since the Federal Reserve Bank is the operating arm of the U.S. Government in the exchange market, it can ensure that purchases of currencies to satisfy government needs do not work counter to U.S. exchange rate policy or to official market intervention activities.

6. The Bank's purchases are settled exclusively in immediately available funds, which results in it receiving a discount on currency purchases since the market rates are based on clearinghouse funds; the Bank passes on the full value of the discount on immediately available funds to its customers.

Military personnel in Japan were concerned that the Federal Reserve Bank might give priority to intervention objectives and the agencies would not get the best prices available in the market for currency purchases for operating needs. A Bank official said that, although the Bank may decide not to buy the currency needed for Government operations in the market, it could provide such currencies from resources available for intervention and that the exchange rates provided to Government agencies would always be equivalent to current market rates at time of receipt of the order.

Officials of a commercial bank said that purchases of foreign currency for Government operating needs would complement the Federal Reserve Bank's intervention activities and that foreign exchange traders' uncertainty as to why the Bank was in the market would be an advantage to the United States. A Treasury official who did not agree with the above reasoning said that the Federal Reserve Bank's assumption of responsibilities for purchasing the currencies needed for Government expenditures might interfere with the Bank's responsibilities for intervention operations to counter disorderly market conditions and might lead to undesirable confusion in the market.

We compared rates obtained by Defense for marks and yen under existing arrangements with rates available to the Federal Reserve Bank in the New York market from July 1978 through February 1979. The results for this 8 months showed New York rates to be competitive with rates obtained under existing arrangements. Rates in New York were slightly more favorable for marks and slightly less favorable for yen.

Defense usually purchases marks from the West German Central Bank every business day at the fixing rate determined in Frankfurt each afternoon at 1 p.m. Because of the 6-hour time difference between Germany and New York, the New York foreign exchange market is not open at that time (7 a.m. in New York). We therefore compared fixing rates with 9 a.m. opening rates for that day in New York and 4 p.m. New York closing rates for the previous day from July 1978 through February 1979. The results are shown below.

Rate	Number of days (note a)	Average daily exchange rate (marks to the dollar)
New York closing	161	1.9205
Frankfurt fixing	169	1.9194
New York opening	162	1.9192

a/Total days for each rate are not the same because the New York market is closed on certain holidays not observed in Germany.

If the New York rates are increased to reflect the discount obtained by the Federal Reserve Bank for settling in immediately available funds instead of clearinghouse funds, the average daily New York closing rate is 1.9212 marks to $1 and the average daily opening rate is 1.9199 marks to $1. Thus, both New York rates, as adjusted, are somewhat better than the fixing rate.

Defense purchases yen from the Dai-Ichi Kangyo Bank almost daily at 16 sen above the fixing rate determined in Tokyo each morning at 10 a.m. (9 p.m. e.s.t. the previous day in New York). Since the New York market is not open at that time, we compared the New York rates before and after the fixing with the purchase rate. We used the New York closing rate for the day before the fixing and the New York opening rate for the day of the fixing.

The comparisons, as set forth below, show that from July 1978 to February 1979, both New York rates were somewhat less favorable than rates obtained from Dai-Ichi Kangyo.

Rate	Number of days (note a)	Average daily exchange rate (yen to the dollar)
New York closing	150	b193.17
Dai-Ichi Kangyo	157	193.49
New York opening	151	b193.19

a/Total days for each rate are not the same because the New York market is closed on certain holidays not observed in Japan.

b/Reflects adjustment for settlement by Federal Reserve Bank in immediately available funds instead of clearinghouse funds.

From the standpoint of buying foreign currencies at competitive rates and servicing Defense needs, there seems to be no particular advantage in using the Federal Reserve Bank to buy such currencies as German marks and Japanese yen. However, the information available to us concerning Treasury and Federal Reserve foreign exchange operations to counter such periodic disorderly monetary market conditions as speculative pressures appeared to support the desirability for coordinating the large annual Defense purchases (about $2.6 billion in marks and $1.0 billion in yen) with foreign exchange intervention operations.

Other than for selected currencies, such as marks and yen, it did not seem advantageous for monetary intervention purposes to have Government agencies buy their foreign currency through the Federal Reserve Bank.

GAO PROPOSAL AND AGENCY COMMENTS

We proposed that the Secretary of the Treasury, in cooperation with the Chairman of the Federal Reserve Board, arrange to have the Federal Reserve Bank of New York manage the acquisition of foreign currencies, especially German marks and Japanese yen, to meet U.S. Government operating needs in other countries.

As we neither have nor seek access to review U.S. international monetary policies and interventions, we recognized that the merits of this proposal would need to be assessed by the responsible agencies.

In commenting on our proposal (see apps. I and II), the Board and the Bank both said that, although they have the capabilities to do so, there appeared to be no special benefit in coordinating foreign currency purchases with intervention transactions and they would assume the function only if requested to do so. Treasury concurred with this view (see app. III), and we have, therefore, withdrawn this proposal.

Treasury and Defense expressed some concerns as to whether the Federal Reserve Bank of New York could at a competitive cost provide the comparable services available under current arrangements for purchasing German marks and Japanese yen. We understand that the agencies did not talk with Bank officials to determine the validity of their concerns. The resolution of such technical issues would not seem important in view of the consensus that there was no special benefit in coordinating Government foreign currency purchases with intervention transactions.

CHAPTER 3

SCOPE OF REVIEW

We examined Government procedures for purchasing foreign currencies through the West German Central Bank, Dai-Ichi Kangyo Bank in Tokyo, State Department finance centers in Paris and Bangkok, and Federal Reserve Bank of New York. We reviewed Defense and State procedures for buying Korean won, a nonflexible currency, and obtained limited information about State's arrangements for purchasing other such currencies. Also, we reviewed public information about Treasury and Federal Reserve foreign exchange intervention operations and other information provided by the Federal Reserve Bank of New York. We may not review specific Treasury and Federal Reserve foreign exchange intervention transactions.

We interviewed officials of the (1) Departments of Defense, State, and Treasury and of the Federal Reserve Bank of New York in Washington, D.C., and New York City, (2) military commands and banking facilities in Frankfurt, Heidelberg, and Ramstein, West Germany and in Toyko, Japan, and (3) State Department regional finance centers in Paris and Bangkok. We interviewed commercial banking officials in New York, Frankfurt, Paris, Tokyo, and Bangkok. Our work overseas was performed during October to December 1978 and in Washington from September 1978 to June 1979.

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PAUL A VOLCKER
PRESIDENT

June 6, 1979

Mr. Allen R. Voss, Director
United States General
Accounting Office
441 G Street N.W.
Washington, D.C. 20548

Dear Mr. Voss:

Thank you for the opportunity to review and comment on the General Accounting Office's draft report entitled "Changes Needed in Government Procedures for Buying Some Foreign Currencies."

Your report recommends that the acquisition of German marks and Japanese yen needed for the U. S. Government's overseas operations be managed by the Federal Reserve Bank of New York in order to coordinate this activity with the intervention operations undertaken to implement U. S. economic and financial policies. From a technical point of view, the purchase of these currencies by the Federal Reserve's trading desk for the Department of Defense appears feasible, although as the report seems to suggest, no clear price advantage should be anticipated. It should also be noted that reporting of Defense Department activities to the monetary authorities could be instituted. In addition, the Federal Reserve has daily telephone conversations with the German Central Bank from whom Defense purchases their marks.

From the standpoint of the Federal Reserve Bank of New York, we perceive no clear advantage in conducting these activities, but we would technically be prepared to conduct such activities should the appropriate authorities so wish.

Sincerely yours,

Paul A. Volcker

Paul A. Volcker

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

G. WILLIAM MILLER
CHAIRMAN

June 13, 1979

Mr. Allen R. Voss, Director
General Government Division
United States General Accounting Office
441 G Street, NW
Washington, D. C. 20548

Dear Mr. Voss:

Thank you for the opportunity to review and comment on the General Accounting Office's draft report entitled "Changes Needed in Government Procedures for Buying Some Foreign Currencies."

We have studied your report and your recommendation that the Federal Reserve Bank of New York act as agent for the Government in purchasing German marks and Japanese yen.

There appears to be no special benefit to the Federal Reserve in folding foreign currency purchasing in with intervention transactions. It should be understood that the Government's currency requirements could not normally be met from the small balances maintained by the Federal Reserve. However, we see no technical obstacles to having the Trading Desk act as purchasing agent for the Government. In this case, some special arrangement would be necessary in order to keep the accounting of currency purchases separate from the accounting for intervention operations. With these minor reservations, the Federal Reserve is willing to provide currency purchasing services if desired by the departments concerned.

Sincerely,

Bill Miller

THE UNDER SECRETARY OF THE TREASURY
FOR MONETARY AFFAIRS
WASHINGTON, D.C. 20220

JUN 22 1979

Dear Mr. Fasick:

I am pleased to provide Treasury Department comments on the draft report, "Changes Needed in Government Procedures for Buying Some Foreign Currencies". I wish to commend the GAO for its extensive study of this important and complex subject.

The draft report states that "there is not a focal point for the acquisition of U.S. Government foreign currency requirements to meet operating expenses in other countries," in that there is no single purchasing agent for all acquisitions of foreign exchange by the U.S. for its operating needs. However, the Department of the Treasury exercises the overall responsibility for accounting, valuation, reporting and administration of foreign currencies acquired to meet U.S. government requirements.

The draft report recognizes the complexities of buying foreign currency in 118 countries, and accurately describes the arrangements that were used to purchase the equivalent of approximately $5.5 billion in foreign exchange during FY 1978 to meet U.S. Government expenditures. To obtain the best available exchange rates and meet other U.S. objectives in dealing with a wide variety of foreign currency markets, different arrangements and procedures have been developed and adapted. I am pleased to note the findings in the report that, through the use of the various current procedures and arrangements, foreign currencies are being obtained at competitive rates.

While the draft GAO report recognizes that existing arrangements are cost-efficient in obtaining foreign currencies needed by the U.S. for its overseas operations, it nonetheless recommends that those arrangements as they apply to deutschemarks and yen be dismantled and that the Federal Reserve Bank of New York (FRBNY) act as the sole U.S. agent for all purchases of these currencies. This recommendation is supported by the statement that "the information available as to Treasury and Federal Reserve foreign exchange operations to counter periodic disorderly monetary market conditions such as speculative pressures supports the desirability for coordinating the large annual defense purchases ($2.6 billion in marks and $1.0 billion in yen) with foreign exchange intervention operations".

The Treasury does not support this recommendation, for three main reasons.

First, the average daily volume of U.S. Government foreign currency purchases is extremely small in comparison with turnover in the markets concerned, and any effects of such purchases can be taken fully into account under existing arrangements by the U.S. and foreign central banks, with which the U.S. coordinates closely, in deciding upon intervention operations. Centralization of all U.S. government purchases in the FRBNY would make no practical contribution to the conduct of U.S. exchange market operations.

Second, it is implicit in the recommendation that the objective of minimizing the cost of foreign currency purchases would at times be subordinated to intervention objectives, possibly raising the cost of foreign currencies needed for defense and other U.S. Government expenditures as compared with the costs under existing arrangements. It is, moreover, uncertain whether the FRBNY would be in a position to supply needed currencies from its own resources, as suggested in the draft report, and thus whether there would be any savings in transactions costs from this source.

Third, although the draft report acknowledges that there is no particular cost advantage in using the FRBNY as purchasing agent, it fails to recognize that there could be substantial disadvantages. Let me explain.

Approximately one-half of total U.S. Government needs for foreign currencies is met through purchases of deutschemarks directly from the Bundesbank. Under the current arrangements, the previous day's mid-day (1:00 p.m.) Frankfurt "fixing rate" remains available to the U.S. Forces until 11:00 a.m. on the date of acquisition. This provides a degree of choice in the rate applied to the transactions which is highly desirable in terms of minimizing costs. The total amount of deutschemarks required is consolidated daily by the American Express Company, at the Military Banking Facility Headquarters in Frankfurt, which receives information from approximately 82 locations throughout Germany. Under current cash management practices, the finance officers in Germany determine their disbursing needs on the total checks issued each day. Twelve deutschemark checking accounts are maintained by Army and Air Force disbursing officers throughout Germany, all of which are funded on a zero balance basis, i.e., the disbursing officers purchase only the deutschemarks required to cover checks issued during any given day. Maintaining the accounts on a zero balance basis saves the U.S. Government interest expense, and having the capability to purchase marks from the Bundesbank for immediate disbursing needs permits maximum flexibility in funding local currency checking accounts.

If arrangements were made to manage the purchase of marks through the Federal Reserve Bank of New York, or any other facility in this country, the procedures to acquire the currency would become more complex and costly. Under the current system, disbursing officers are notified of the exchange rate throughout Germany to be used to pay vouchers on the day of purchase. Because of the time difference between Frankfurt and New York, currently six hours, the purchase procedures would be extended one full day if they were to be handled through New York. Any delay caused by telecommunications would have an adverse impact on the Treasury cash management program of maintaining zero balance checking accounts in Germany. The military disbursing officers would have to anticipate disbursement requirements for holidays, both in Germany and the United States, and make necessary purchase arrangements 3 to 4 days in advance. Thus, without offering an advantage of obtaining more favorable exchange rates, the GAO proposal would require the maintenance of substantially increased bank balances as well as increase the administrative costs.

The problems in funding Japanese yen operating accounts from New York would be similar to those in Germany. The time difference between Tokyo and New York is currently 13 hours, thus complicating even further the procedures that would need to be utilized by the U.S. Forces in communicating and confirming daily purchases of yen. Also, it is questionable whether yen-denominated bank balances could continue to be funded on a zero balance basis.

A brief comment is warranted regarding the State Department's procedure for purchases of yen. The Regional Finance Center in Bangkok, operated by the Department of State, is currently used to provide U.S. Government currency requirements throughout the Far East. Originally, one of the options was to use the Finance Center to purchase the Japanese yen requirements for the military; however, it was determined that the Center did not have the communications capability. Subsequent to the survey conducted by the GAO staff, however, the capability of the Finance Center has been improved. A new telex trunk line has expanded the telex capabilities of the Bangkok Processing Center. It now takes only 3 - 4 minutes to obtain and service a quote over the telex lines in Bangkok. The Treasury as well as the Center is constantly reviewing its purchase procedures to insure that the U.S. Government is receiving the most beneficial exchange rates available.

On an additional technical point raised in the draft report, concerning the acquisition of certain other currencies, Treasury concurs in the view that foreign currencies with official fixed conversion rates in relation to the dollar should be obtained at rates no less favorable than the official rates. However, not all currencies can be obtained at the published official rates, since many are adjusted for bank conversion fees. In addition, the U.S. Disbursing Officer in Paris has advised that rates quoted for these currencies are sometimes estimated to allow for bank charges; for example, it usually takes a week or longer to confirm the actual rate for purchasing Yemeni rials. A further review of all arrangements for obtaining currencies with fixed exchange rates will be conducted to ascertain that the U.S. Government is obtaining the most advantageous rates available.

In sum, the Treasury is keeping under continuous review the U.S. Government arrangements for acquisition of foreign currencies for U.S. Government expenditures in order to assure the most cost-efficient means of obtaining those currencies. In our view, it would serve no useful purpose at present -- and could, for the reasons outlined above, prove costly to government programs -- to centralize all U.S. purchases of deutschemarks and yen in the FRBNY.

Sincerely yours,

Anthony M. Solomon

Anthony M. Solomon

Mr. J. K. Fasick
Director
International Division
U.S. General Accounting Office
Washington, D. C. 20548

DEPARTMENT OF STATE

Washington, D.C. 20520

July 10, 1979

Mr. J. Kenneth Fasick
Director
International Division
U.S. General Accounting Office
Washington, D.C.

Dear Mr. Fasick:

I am replying to your letter May 15, 1979, which forwarded copies of the draft report: "Changes Needed in Government Procedures for Buying Some Foreign Currencies".

We appreciate having had the opportunity to review and comment on the draft report. If I may be of further assistance, I trust you will let me know.

Sincerely,

Roger B. Feldman

Roger B. Feldman
Deputy Assistant Secretary
for Budget and Finance

Enclosure:
As stated

A/BF/FC RESPONSE TO GAO DRAFT REPORT, ENTITLED "CHANGES NEEDED IN GOVERNMENT PROCEDURES FOR BUYING SOME FOREIGN CURRENCIES

We have reviewed your draft report "Changes Needed in Government Procedures for Buying Some Foreign Currencies". We appreciate the fine efforts required to bring together information and data in this complicated subject area.

We consider that the major thrust of the report is directed to the Department of the Treasury since that Department by statute and Executive Order is charged with the primary responsibility for administration of the acquisition, custody, deposit, sale, and reporting of foreign currencies by Executive departments and agencies. The Department of State, both in Washington and its overseas offices, coordinates with the Treasury Department in the administration of foreign currencies generated by U.S. programs abroad or acquired by purchase with U.S. dollars.

The objectives of the report were (1) to assess whether it would be advantageous to the United States to coordinate foreign currency purchases with monetary intervention operations and (2) to determine whether the Government obtained favorable rates in purchasing currencies needed for its operations abroad.

COORDINATION OF GOVERNMENTAL FOREIGN CURRENCY PURCHASES WITH MONETARY INTERVENTION OPERATIONS

Since the Department of State is not responsible for intervention activities, we are not in a position to comment comprehensively on your recommendation that the Secretary of the Treasury and the Federal Reserve Board arrange for the Federal Reserve Bank of New York to manage the acquisition of foreign currencies to meet U.S. Government operating needs. Your report mentions that selected currencies were being obtained at competitive rates under present procedures. For example, on page 14 the report indicates that the Paris Finance Center is able to compare the Bundesbank daily fixing rate with rates on other European markets and select the most favorable. We believe that maximum cash management benefits might be more difficult to achieve if transactions were handled in New York, especially if acquisitions for operating needs were subordinated to intervention decisions.

ARRANGEMENTS TO OBTAIN U.S. YEN REQUIREMENTS UNDER DEFENSE DEPARTMENT PROCUREMENT

The Department of State is coordinating constantly with the Treasury Department in developing procedures that will result in the most favorable purchase arrangements for Japanese yen to meet U.S. Government expenditures. We are finalizing our decisions on the most suitable methods. It is likely that the contract with the Dai-Ichi Kangyo Bank Tokyo to meet Defense needs will be renewed at the beginning of the fiscal year. We expect that provisions for acquisition of all U.S. Government yen needs will be included unless there is a more favorable offer from a competitive banking institution.

ARRANGEMENTS TO INSURE CURRENCIES ARE PROCURED AT OFFICIALLY CONTROLLED RATES

Treasury and State Department regulations require that currencies needed for operations be purchased at the most favorable rate legally available for the purpose of the procurement. We will coordinate with the Treasury Department in reviewing procedures followed for procurement of currencies in countries with official fixed rates.

With regard to the use of International Monetary Fund statistics on official rates, central banks are generally concerned with monetary policy including the fixing of exchange rates for transactions between central banks and domestic banking institutions. Sale of currencies for commercial or private use is usually carried out by the commercial banking system. Rates available in the marketplace may be more indicative of the actual costs of acquiring currencies that the official central bank rates, insomuch as they reflect bank charges. We are making inquiries on the reasons for the exchange rate difference cited in the report.

SUMMARY

The Department will continue to cooperate and coordinate with the Treasury Department in constantly striving to improve procedures for the acquisition of foreign currencies for operating requirements. We expect

APPENDIX IV

this to be a continuing challenge in a world of floating exchange rates and wide-spread monetary instability.

Roger B. Feldman

Roger B. Feldman
Deputy Assistant Secretary
for Budget and Finance

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