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CONGRESS SHOULD GIVE NO MORE FUNDS TO THE IMF

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President Clinton is gearing up for a battle with Congress over increased United States funding for the International Monetary Fund (IMF). The IMF-led \$118 billion bailout of Asian economies and IMF demands for substantial funding increases have prompted Congress to question both the efficacy of financial bailouts and the relevance of the Fund in today's global economy. While the IMF and its international partners have the resources to meet their obligations in Asia, intervention has reduced the Fund's liquidity. Thus, the question on Capitol Hill is whether the IMF should be granted the funds necessary for future rescues or, alternatively, should cease to exist.

Granting the IMF any additional funds would be a mistake. The Fund's resources are more than sufficient. The IMF has revealed that it had \$85.62 billion in liquid resources in April 1997—nearly \$8.6 billion more than the previous April.¹ Its portion of the Asian package totaled \$36 billion. Since

1990, the IMF has averaged a \$3.14 billion net annual change in its outstanding credit. Thus, even if the entire Asian package is deducted, normal IMF activities would leave \$46.86 billion in IMF resources.² Moreover, the Fund's 1997 annual report indicates anticipated income of approximately \$28.32 billion from loan repayment and repurchases by the end of the year 2000.³ With its current resources and near-term income, the IMF therefore should have more than enough money to partici-

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1. "IMF Position Improves," *IMF Survey Supplement on the Fund: Liquidity*, September 1997; available on the Internet at <http://www.IMF.org/external/pubs/ft/survey/sup0997/11liquid.htm>. IMF claims of illiquidity would indicate the extension of some \$86 billion since April 1997.
 2. International Monetary Fund, *Annual Report 1997*, p. 172. All IMF account figures were converted from the IMF's unit of account, the Special Drawing Right, at 1 to 1.36553 U.S. dollars, as specified in the Fund's 1997 annual report.
 3. *Ibid.*, Financial Statements, p. 245.

pate in two future bailouts equivalent to the one in Asia.

MORE HARM THAN GOOD

Supporters of the IMF advance a number of reasons to justify its role in the global economy. IMF action, they claim, is necessary to alleviate international financial crises and the resulting harm to the citizens of troubled countries. Proponents also dismiss critics of the Fund as shortsighted isolationists. Close examination, however, refutes these claims.

- **IMF activities are more likely to cause crises than to prevent them.** Every investment has an associated risk. In general, the greater the risk, the greater the return the investor demands from the investment to compensate for the greater probability of failure. Market prices and returns on investments convey crucial information about the relative risks of investment alternatives. If these prices and relative return data are obscured or distorted by government policies, investors cannot make informed decisions about the security and productivity of their investments.

The possibility of an IMF rescue creates what economists refer to as a “moral hazard.” Bailouts effectively shield investors and politicians from the consequences of their poor economic decisions by “socializing” risks and reducing the costs of failure associated with an investment. Risks are socialized because everyone ends up paying for an individual investor’s errors; the costs of failure are reduced because, directly or indirectly, the IMF compensates investors when their investment plans fail. In other words, IMF bailouts encourage speculation of the sort that investors probably would avoid if the IMF were not there to shield them from failure. Bailouts also send signals to governments that they will not have to bear the costs of failing to reform their economies: The IMF will be there to pay the price of their inaction. Thus, the IMF’s actions do not prevent or cure crises—they encourage them.

Financial hardship and defaults occur every day in the U.S. economy. They are a necessary and natural reflection of free markets. Bankruptcy is the market’s method of reallocating capital to more productive uses, or away from managers who have failed to create wealth for investors and improve the well-being of consumers. As assets are purchased at a reduced rate by the highest bidder, both parties to an ill-considered lending or investment decision suffer a loss; but the overall economy profits because new, presumably better managers will now control the capital.

In the international market, however, the IMF distorts this mechanism by rewarding inept managers with financial assistance. Without the IMF, borrowers and creditors would be forced to resolve the situation in the Asian countries by renegotiating loans or seizing assets. A world without the IMF would have to observe the greater discipline of market forces. Banks and investors would be more cautious in assessing risk before investing or committing loans. Countries wishing to receive foreign loans and investment would have to adopt economic policies that lower the risk for lenders and investors; specifically, they would have to create fair and reliable bankruptcy laws, employ transparent and internationally accepted accounting procedures, allow minimal government interference in the allocation of credit, exercise prudent oversight of their banking systems, and encourage rather than prevent domestic and foreign banking competition.

- **Investors, not people or countries, are being bailed out.** The IMF claims that it must act to help the people of a troubled country. This is false. Providing money to a government merely allows that government to meet its own debt obligations to private-sector and public-sector creditors. On one hand, an IMF bailout allows a government to pay its debts to large international banks; on the other, it allows a country to meet its short-term obligations to public-sector creditors, such as the IMF and the World Bank. In effect, therefore, instead of

helping the people, part of the IMF assistance is helping the country to pay off its debt to the IMF itself.

IMF rescues help neither the economies of recipient countries nor the majority of their citizens. In the wake of the Mexican bailout in 1995, for example, the Mexican people suffered a sharp decline in their standard of living, large increases in unemployment, and an overnight erosion of savings. Investors, however, escaped with minimal losses. This scenario has been replayed time and time again. Indonesia, South Korea, and Thailand all have experienced similar hardships despite the IMF-led rescue package. As in Mexico, the current IMF financial package in Asia salvages the profit margins of international lenders and large borrowers by guaranteeing their loans. Meanwhile, the citizens of these countries pay the tab on the rescue package through higher taxes or currency devaluation (which reduce purchasing power and savings) in the hope that increased exports will provide the foreign exchange to pay a drastically increased foreign debt.

- **Fears that the Asian crisis will expand and lead to a second Great Depression are overblown.** Those who argue that the Asian crisis could lead to a global economic meltdown are overstating the case. For example, according to the Bank for International Settlements, U.S. private-sector exposure in Indonesia, Malaysia, the Philippines, South Korea, and Thailand is only \$23.8 billion—some 18 percent of U.S. banks' international lending.⁴ While a total loss of this \$23.8 billion—which, it should be noted, is extremely unlikely—certainly would affect the profitability of U.S. banks in the short term, it would not threaten their viability. Indeed, U.S. banks remain healthy despite

much larger domestic losses. The cost to the American economy from personal bankruptcies was over \$44 billion last year according to a new study from the respected econometric research firm, WEFA Inc.⁵

Another concern expressed by proponents of the IMF is that the crisis might spread to Japan. This concern is exaggerated as well. Japan is the world's largest creditor nation and reported nearly \$230 billion in foreign exchange reserves in October 1997. According to the Bank for International Settlements, Japanese private-sector exposure in Indonesia, Malaysia, the Philippines, South Korea, and Thailand is \$97.2 billion.⁶ Thus, Japan has the foreign exchange resources to prop up its banks without borrowing in the unlikely event of contagion.

The belief that only a government-led initiative can prevent a global financial crisis reveals an innate arrogance within the IMF. It presumes that the knowledge of the thousand economists at the IMF outstrips the judgment of hundreds of thousands of international financiers, international investors, and currency traders across the world—indeed, that it outstrips the judgment of every consumer. Moreover, it assumes that the economic advisors of 190 nations are so ignorant of history that they would willingly repeat the mistakes that led to the Great Depression, such as imposing tariffs and barriers strong enough to halt international trade, while simultaneously engaging in competitive currency devaluation. At best, multilateral central planning by the IMF can only delay the economic day of reckoning. It is better to have a sharp correction that leads to sustainable growth than to endure an endless series of lesser crises that prolong economic instability and inhibit prosperity.

4. Bank for International Settlements, Monetary and Economic Department, *The Maturity, Sectoral and Nationality Distribution of International Bank Lending*, Basle, January 1998, Table 2; available on the Internet at <http://www.bis.org>.

5. "Econometrics Firm Says 1997 Cost of Personal Bankruptcies Topped \$44 Billion," Bureau of National Affairs, *Daily Report for Executives*, February 11, 1998, p. A-20.

6. See note 4, *supra*.

- **Critics of the IMF are not isolationist; they support sound economic principles and responsible international engagement.** Critics of the IMF have been portrayed as neo-isolationists who would lead the world to another Great Depression. This also is inaccurate. These critics advocate responsible international engagement—the antithesis of isolationism. Former Secretary of State George P. Shultz, former Secretary of the Treasury William E. Simon, and former Citicorp/Citibank Chairman Walter B. Wriston recently called for the abolition of the IMF in a *Wall Street Journal* article, noting that “The IMF is ineffective, unnecessary, and obsolete. We do not need another IMF as Mr. [George] Soros recommends. Once the Asian crisis is over, we should abolish the one we have.”⁷ These experts (as well as Nobel Laureate Milton Friedman, who also has urged Congress not to provide additional money to the IMF) cannot be described as isolationists. On the contrary, all are longtime advocates of responsible U.S. global leadership. They all understand, however, that the IMF does more harm than good and that people would suffer less in the long term, and most likely in the short term, in a world without the market distortions created by its actions.

WHAT CONGRESS SHOULD DO

Congress is right to question the wisdom of continuing to fund an organization that transfers money from American taxpayers to large international lenders and borrowers, fails to soothe popular suffering in troubled countries, and encourages reckless risk-taking by policymakers and international investors. An organization that has proven itself inept in accomplishing its chosen missions for two decades does not deserve greater funding. The U.S. Congress therefore should:

- **Refuse to approve additional funding for the IMF.** President Clinton has asked Congress to increase funding for the IMF during the next fiscal year in two ways. The first is by granting the IMF \$3.4 billion for an emergency line of credit, the New Arrangements to Borrow (NAB). The second is through a 45 percent increase in the Fund’s quota subscriptions, which provide the money for its main account, known as the General Resources Account. The U.S. portion of this increase is \$14.5 billion.⁸
- **Immediately examine the necessity and relevance of the International Monetary Fund.** Should Congress determine that the IMF is no longer relevant, it should take steps to eliminate it. Representative Ron Paul (R-TX), for example, has introduced legislation—Withdraw the United States from the International Monetary Fund (H.R. 3090)—which would direct the Secretary of the Treasury to withdraw from the IMF as specified in the IMF Articles of Agreement.

CONCLUSION

The IMF has a poor record when it comes to inducing countries to embrace economic reform. This is because outside organizations like the IMF cannot impose a solution to an essentially internal problem; there must be a domestic political desire to implement economic reform. Without this political will, there is little chance of fundamental economic reform no matter how much money the IMF has available. The hard fact is that if a country truly desires to implement economic reform, organizations like the IMF are superfluous.

The truth underlying the Asian crisis is that the countries being bailed out by the IMF fell into their current financial morass largely through their own shortsighted economic policies. Likewise, international lenders and investors understand the risks associated with their ventures. Congress

7. William E. Simon, George P. Shultz, and Walter B. Wriston, “Who Needs the IMF?” *The Wall Street Journal*, February 3, 1998, p. A22.

8. *Budget of the United States Government, Fiscal Year 1999*, Appendix, pp. 969–970.

should take an objective look at the facts, ignore the alarmist arguments of IMF advocates, and recognize that it is past time to let countries and investors know that they will be held accountable for the consequences of their decisions. It can do

this by refusing to grant any additional funding to the IMF.

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