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# THE IMF PROMOTES POOR BANKING PRACTICES

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In the wake of recent financial crises, experts are advancing proposals for strengthening the international financial system. In many of these plans, the International Monetary Fund (IMF) figures prominently as a source of emergency credit and promoter of sound banking practice.

Unfortunately, the record of the IMF as banker to governments in financial distress does not inspire confidence. The IMF egregiously violates sound banking practices, calling into question its condemnation of the poor financial systems of loan recipients. Most recently, the decision to lend to Russia, a country that has defaulted on its debt and shows little dedication to economic reform, demonstrates that the IMF is a poor role model for sound banking.

## Poor Banking Policy Contributes to Crises

Although the circumstances leading to financial crisis in Latin America, Asia, and Russia differed in many respects, a common thread was a lack of adequate banking supervision, transparency, and oversight.

Many countries use the banking system as an instrument of development strategy. The government chooses industries and ventures it believes will contribute to development. It then directs credit to these "winners," often by encouraging commercial lenders to favor those industries. This policy undermines the growth of a sound banking system by preventing banks from assessing loan applications on the basis of such criteria as likelihood of repayment and available collateral.

These highly regulated banking systems provide the perfect means for corrupt officials to funnel funds to politically connected industries and individuals. Overall financial instability increases because loan assessments based on economic and business criteria, including financial viability, are suppressed in favor of loans made for political priorities. Such a system produces more bad loans and losses than a banking system based on sound credit practices.

Nontransparent accounting to conceal lax lending policies also frequently hinders these systems. The lack of transparency conceals the nature of the lending institutions' overall risk and exposure, increasing the likelihood that sound financial institutions will enter into business with these corrupted banks. This system exacerbated the Asian financial crisis in 1997–1998, which otherwise would likely have been a limited, regional crisis.

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## Setting a Poor Example

In exchange for billions in credit to governments around the world, the IMF requires countries to implement specific policy changes to address the cause of the financial instability. Broad financial service reform, especially of commercial banking, has become a favorite IMF policy prescription. Typically, this includes writing off bad loans, closing bankrupt institutions, and improving oversight of banking practices.

Would that the IMF followed its own advice. Instead of restricting or denying credit to countries with a record of resisting economic reform, the IMF eagerly enters into loan after loan. The most recent and glaring example of this practice is Russia. Despite over $27 billion in IMF credits since 1992, the Russian government has been unwilling or unable to reform the economy. It has defaulted on much of its debt. It has even admitted that as much as $50 billion in Central Bank reserves, including IMF loan proceeds, was siphoned off for questionable purposes with the cooperation of Russian officials.

Yet the IMF continues to serve as Russia's banker. A preliminary agreement was reached on March 29 between IMF Managing Director Michel Camdessus and Russian Prime Minister Yevgeny Primakov to provide $4.8 billion in new loans to Russia in 1999. Not so coincidentally, this is almost exactly the amount that Russia owes the IMF in 1999 for past loans.

The IMF proposal to lend additional funds to Russia, despite its defaults, is simply bad banking practice. It is not unlike a banker's lending to a friend who subsequently defaults on the loan. Then, perhaps out of friendship or a desire to conceal the error in making the original loan, the banker lends additional funds to enable the friend to keep current on the first loan. Whatever the motivation, the banker is perpetrating an accounting fraud that likely will land him in deep trouble. Bank examiners could compel him to write down the value of the loan and take a charge against earnings for the portion of the loans not recoverable. The entire loan might have to be written off. Additionally, the bank could be cited for bad banking practices and the banker cited individually for his actions.

The IMF, by contrast, is rewarded with ever-greater funds to cover its errors.

Russia is only the most recent example of decades of poor banking practice on the part of the IMF. Another is Peru, which entered into 17 different arrangements with the IMF between 1971 and 1977 despite repeated failure to meet many of the reform conditions that accompanied the loans. In effect, these IMF loans financed the destructive economic policies that made Peru less able to repay its debt. A third example is the $3.4 billion IMF loan to Mexico only one year after that country had initiated the 1982 Latin American debt crisis by defaulting on its debt.

## Conclusion

Despite the IMF's vocal support for sound banking principles, its actions tell a different story. The IMF exports poor banking practice by example. It damages the international financial system when it continues to lend to countries like Russia, a financial black hole.

In an October 1998 statement, the IMF noted that "Markets do not operate well when…transparency and accountability are lacking, and market participants do not operate under an internationally accepted set of principles or standards." The world economy will continue to suffer so long as IMF actions fail to match IMF rhetoric.

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