

Abolish the IMF
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The International Monetary Fund was created in 1944 at the United Nations International Monetary Conference held in Bretton Woods, New Hampshire. The Articles of Agreement were ratified in 1945.

The IMF is headquartered in Washington, DC, and has an international staff of 2600.

The IMF was intended to help countries finance imbalances in their foreign exchange payments in international trade by means of loans called "drawing rights". The IMF loans would prevent exchange controls and the competitive devaluations of currencies.

If a country has a fixed exchange rate with the dollar and it imports more goods than it exports, and if this trade deficit is not offset by investment funds coming into the country, the country needs to borrow funds to pay for the excess imports.

The pre World War I global economy did not require an IMF. That is because, in effect, the old global economy had a common currency, namely gold. The amount of purchasing media was not restricted by the amount of gold, because most of the transactions used bank notes.

In many countries, such as in the United States, a central bank or the Treasury department issued the national currency and controlled its supply. In contrast, in some countries or jurisdictions, there was free-market banking. With free banking, private banks could issue their own bank notes. Both the private bank notes and demand deposits were convertible into gold. Also, with free banking, there are no restrictions on bank branches. The United States never had free-market banking.

The gold standard broke down during World War I and the Great Depression. After World War I, countries did not return to the pure gold standard, but rather to a mixed system. Gold was still used, but national currencies became controlled by central banks, such as the Federal Reserve System, established in 1913.

After World War II, rather than go back to the gold standard, the Bretton Woods conference set up a system where the international reserve currency was now the dollar, rather than gold, but the U.S. dollar was still convertible into gold internationally.

Why did these economists and officials not want to go back to gold? Gold became discredited during the Great Depression, being associated with the old system,

but a sound monetary system needs not just sound money but also, even more importantly, a free market in the money supply and in setting interest rates. With free banking, the rigidity of gold as "outside money" anchors the value of money, but the flexibility of bank notes and checking accounts as "inside money" lets the system adjust to changing demands.

The basic problem with the Bretton Woods monetary system was price controls. There was a price control on the US dollar relative to gold, and the other currencies had price controls relative to the dollar. With price controls we eventually get shortages or surpluses.

Each country had a fixed exchange rate with the U.S. dollar, and therefore with other currencies. If a country imported more than it exported, the imbalance was filled by the importer converting domestic currency to dollars, and exporting dollars. But, what if the country ran out of dollar reserves? The country's monetary authority would borrow dollars from the IMF to deal with this temporary shortage of dollars. If the problem was deeper, and the trade was still imbalanced, the country would have to devalue (meaning, change the exchange rate so one franc bought less dollars)..

In those days, it was illegal for Americans to own gold, but a foreign government, such as France, could exchange dollars for gold at the fixed price of \$35 per ounce. If too much gold left the US, the unstable pyramid would collapse, which is exactly what happened. The Fed expanded the supply of dollars at a rate that was faster than the expansion of the demand for dollars. The \$35 per ounce rate was not natural or really viable. The gold-exchange system was finally terminated by President Nixon in 1971, when he formally ended the international convertibility of the dollar. The last tie to gold was severed.

When the Bretton Woods system collapsed, it was replaced by a pure fiat money system, in which the U.S. dollar along with all other currencies are not based on any real commodity.

Economists use the metaphor of a float, currencies bobbing up and down as financial waves affect the supply and demand. The currencies of the major countries float. But a few countries such as Hong Kong and Estonia have *currency boards* instead of central banks. Their currencies are based on the currency of another country at a fixed rate, and the currency board has enough currency reserves, or the equivalent such as bonds in that currency, to cover conversions.

Many developing countries have pegged their currency to another currency such as the dollar, but without sufficient reserves to guarantee complete convertibility. In that case, the monetary authority can get into trouble if there is a run on the currency, if foreigners want to convert out of the national currency, but there are insufficient reserves to meet the demand. In that case, the government can turn to the IMF for a loan.

In an article in the *Wall Street Journal* in 1999, economist Judy Shelton sees the world monetary system as having "broken down. Price signals are distorted by gyrating currencies that create a house of mirrors for asset valuation, leaving investors without an accurate reflection of global economic opportunity and risk. Misdirected capital flows and economic dislocations stem from distorted perceptions about the relative rates of return from seemingly productive investment projects." Shelton states that the fundamental global economic problem is the lack of a "global unit of account for signaling value across borders."

But even aside from problems with money systems, the IMF itself has deep flaws. The IMF is like an economic doctor. National governments are its patients. Many of the patients are like people who keep getting drunk on alcohol. They have unhealthy monetary and fiscal lifestyles. So they keep getting sick, and they go to the IMF doctor for help. Unfortunately, rather than curing the patients, the IMF often gives them policy medicine that not only makes their illness worse, their pain also gets worse.

Since the world has gone to a fiat money standard, where the major currencies float, the original mission of the IMF, to help maintain the fixed-rates with temporary loans, has dissolved. The IMF has therefore undergone a mission creep, or more accurately, a mission leap.

The IMF now makes long term loans to developing countries, and provides ongoing rather than just temporary financing. From 1972 to 1999, the IMF capital base rose 127 percent in real terms, to \$281 billion.

To eliminate a budget deficit, the IMF typically tells the government to raise taxes and cut spending. Normally, balancing the budget for consumption is good practice, but when the economy is injured, many people are unemployed and there is a great need to restore enterprise and investment.

IMF prescriptions to tighten monetary policy decrease bank reserves and increase interest rates often to extreme levels often above 20 or even 50 percent. It becomes very difficult for business to operate at such rates. When the IMF eliminates food and fuel subsidies for the poor, people riot, as happened in Indonesia, Bolivia, Ecuador, and other countries.

Joseph Stiglitz, chief economist at the World Bank from 1997 to 2000, wrote a scathing analysis of the IMF, *Globalization and Its Discontents*. According to Stiglitz, IMF decisions are often based on bad economics and doctrines that, as he puts it, "seemed to be thinly veiling special interests."

Stiglitz states, "When crises hit, the IMF prescribed outmoded, inappropriate, if 'standard' solutions, without considering the effects they would have on the people in the countries told to follow these policies. Rarely did I see forecasts about what the policies would do to poverty. Rarely did I see thoughtful discussions and analyses of the consequences of alternative policies..."

Stiglitz states that the IMF "remedies failed as often, or even more often than they worked. IMF structural adjustment policies ... led to hunger and riots in many countries; and even when results were not so dire, even when they managed to eke out some growth for a while, often the benefits went disproportionately to the better-off, with those at the bottom sometimes facing even greater poverty... [T]he level of pain in developing countries created in the process of globalization and development as it has been guided by the IMF and the international economic organizations has been far greater than necessary."

In the early 1990s, the IMF told African countries to implement austerity policies as a condition for loans. Imports became costlier, including fertilizer and farm inputs. Rural banks and credit programs were shut down. Meanwhile, the U.S. and Europe exported subsidized food and cotton. These changes "impoverished millions of subsistence farmers and villagers." Poverty has increased in Zambia, Mozambique, Malawi, and other countries that have enacted IMF and World Bank agricultural policies.

Even when the economy grows, the distribution of the benefits also matters. In Mexico the benefits of growth have gone to the upper 30 percent and even more concentratedly to the top 10 percent of the population, while those at the bottom gained little or are even worse off. The government of Mexico paid back its loans to the US and the IMF, but its GDP hardly rose from 1973 to 1997, while its per-capita debt more than tripled. With higher taxes to pay the interest, the net-of-tax income of Mexicans declined.

There is a word for an illness caused or made worse by the doctor: *iatrogenic*. IMF policies are too often iatrogenic, creating an even worse problem for the afflicted economy. Several studies have concluded that IMF policies are iatrogenic.

A survey of the studies of the effects of IMF programs by Mohsin Khan finds that they do not affect inflation, and the effects of growth vary and are uncertain.

Sebastian Edwards finds that in the 1980s, the effects of conditionality were that current accounts improved but inflation increased.

Doug Bandow examined financing activities from 1947 through 1989 and discovered that six countries relied on IMF assistance for more than thirty years, twenty-four countries for twenty to twenty-nine years, and forty-seven countries for ten to nineteen years. Of the eighty-three developing countries that used IMF resources for at least 60 percent of the years since they started borrowing, more than half, forty-three nations, have relied on the IMF every year.

Graham Bird concludes that "the image of the fund coming into a country, offering swift financial support, helping to turn the balance of payments around, and then getting out, is purely and simply wrong."

A sign of iatrogenic practice is when patients get sick more often and longer than if they are not treated. Johnson and Shaefer report that for less-developed countries, "IMF lending is more likely to create long-term dependency than to act as short-term assistance."

From 1965 to 1995, of the 137 countries receiving IMF loans, for 81 countries the frequency of borrowing increased 50 percent after 1980.

If a government cannot pay its IMF debt, it typically renegotiates its debt and borrows more money. People and enterprises are then heavily taxed to pay for debts incurred in the past, but which provide no current benefits.

Who benefits from IMF practices? Among the prime beneficiaries of this policy are the banks that loaned money to these countries. The IMF acts as their debt collector and loan guarantor. In the Asian crisis of 1997, the \$95 billion lent by the IMF and the G-7 countries enabled the recipients to provide dollars to the firms that had borrowed from Western bankers.

The very presence of the IMF creates the perverse incentive called *moral hazard*. Moral hazard occurs in insurance when the presence of insurance makes it more likely that the insured party indulge in the behavior insured against. People will engage in riskier behavior if they don't bear the full consequence. The availability of the IMF as the bailed out of last resort provides less incentive for dysfunctional governments to avoid excessive deficits and less incentive for private lenders to be prudent.

To avoid moral hazard, a lender of last resort should charge a premium for emergency loans. But the IMF does the opposite, providing loans at a subsidized rate. A lender of last resort should provide funds to organizations that are solvent but have temporary liquidity problems, while the IMF also makes loans to insolvent governments. Moral hazard is also reduced by requiring collateral on the borrower's assets. Moral hazard helps prevent the sound fiscal and monetary policies that would prevent the cycle of boom and bust.

The IMF is supposed to prevent contagion, the spread of financial injuries to other countries, like a doctor seeking to prevent the spread of disease. But the IMF failed. In the past 15 years, there have been over 90 serious banking crises, many of them followed by deep depressions. The Mexico bailout created moral hazard that made the Asian crisis worse.

The Thai crisis soon spread throughout Southeast Asia to Malaysia, Indonesia, and the Philippines, as they too had high current account deficits, fixed exchange rates with insufficient reserves, huge debts, and reduced competitiveness. Then came the Russian crisis of 1998.

Another aspect of moral hazard is the perpetuation of corruption. Robert Keleher cites several studies that find that foreign assistance rather than promoting reform instead

strengthens existing governmental institutions. The IMF's own research staff identified many of the recipient countries as corrupt. IMF lending does not discriminate among countries with greater or lesser corruption. Indeed, the IMF lent funds to many corrupt as well as oppressive regimes, including Romania under Ceausescu, Ethiopia under its Marxist regime, and Zaire. The IMF loaned funds to countries such as Zaire and Russia even when its officials knew the funds would be used corruptly. Billions of dollars of IMF "loans" to Russia appeared in foreign bank accounts days after being delivered.

Another effect of the IMF is that the imposition of policies on the borrowing government diminishes the national dialogue over government policy. The imposition of IMF rules crowds out the internal resolution of policy differences, and may weaken reform efforts.

Defenders of the IMF claim that it imposes no cost to US taxpayers. The members of the IMF supply funds when the IMF requests a capital expansion. As of 1999 the total U.S. contribution to the IMF was \$68 billion. U.S. Appropriations bills claim that U.S. contributions to IMF funds will not be counted as an outlay and will not increase the deficit, because each dollar provided is a loan. Former U.S. Treasury Secretary Robert Rubin claimed that "the IMF has not cost the taxpayer one dime".

But economic reality differs from accounting superficialities. IMF loans are deliberately below market rates. The interest that the U.S. government obtains from its IMF accounts has usually been less than the U.S. Treasury's cost of borrowing, i.e. of U.S. Treasury bonds. The Congressional Research Service has calculated that in real terms the IMF has added at least \$4.6 billion to the U.S. national debt.

The main reason the IMF should be abolished is that without it, countries with bad policies would have to face the consequences: bankruptcy, policy change, possibly regime change or deep structural changes. The IMF enables government chiefs to continue their bad policies and stay in power.

If the IMF did not exist, some countries that borrow from it would default, but that would send a signal to lenders to avoid loans that are too risky, and that would induce governments to make more fundamental reforms or be replaced. If the IMF did not exist, countries with pegged exchange rates would convert to either floating exchange rates or currency boards.

Since private capital flees when it is about to get fleeced, governments would have a greater incentive to have more economic freedom, and to have greater transparency in both governments and in capital markets, since failed policies would no longer be subsidized. Private capital markets could act quickly to finance temporary balance of payments deficits due to external shocks, such as a war.

Also, if the IMF did not exist, some of its functions would be transferred to other institutions. I think this could be an improvement, because these other institutions,

such as regional development banks, the World Bank, governments, and private lenders, would most likely not have conditionalities as detrimental as those of the IMF. There could be regional monetary funds that would be more sensitive to the local conditions. If the IMF were abolished, something would need to be done about the debts owed to it. These, along with member drawing rights, could be transferred to the World Bank and eventually be liquidated.

I conclude that the IMF is obsolete, the IMF makes matters worse rather than better, and it will continue to do so, and therefore the world would be better off without the IMF.