THE POLITICS OF IMF LENDING

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> *The world's structure of trade and finance is immensely productive, but it is not stable. It does not balance itself. It has to be managed.*
>
> *Washington Post* (25 July 1983)

> *If the IMF were out of the picture . . . the banks would arrange their own rescheduling of debts, as they do with domestic borrowers in trouble.*
>
> Milton Friedman (3 November 1983)

I. Introduction

The 1983 debate over increasing the funding of the International Monetary Fund (IMF) reflects the basic conflict between the above two views. One school, as exemplified by the first quote, sees the market as a fragile institution requiring the guidance of an impartial and objective government referee to enforce order and stability. The alternative view sees the market as both more robust and far more able to correct world financial problems than a political institution. The former views government as a positive force for good in an otherwise self-centered universe; the latter sees government as merely another forum in which self-interest operates, but one that lacks many of the corrective feedback mechanisms of the marketplace. To the former, government is the solution; to the latter, it is the problem.

The theme of this paper is that a significant change is occurring in the way foreign economic assistance programs are viewed. This change is overdue and parallels a similar reassessment of domestic economic policies. These trends are likely to strengthen the arguments and

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political effectiveness of the array of forces that came to oppose the IMF in 1983.[1] Those favoring increased government-to-government assistance face an increasingly difficult, and I would argue ultimately hopeless, task. As Tom Bethel (1983) has noted: "[T]he IMF is doomed . . . because it has either failed to grasp, or it dare not acknowledge, that capitalism and socialism are not equally effective methods of economic growth." The following sections develop this theme.

Section II provides a brief history of the IMF's financial-management role from its creation at the Bretton Woods conference in 1944 to today. Section III addresses the question of whether the IMF as a political institution is the most effective means of managing the world financial system. The fourth section addresses the advisability of obtaining credit-assessment advice from private firms such as Moody's and Standard & Poor's rather than the IMF. The fifth and central section of the paper addresses the specific arguments raised in the recent legislative debate over whether the United States should increase its quota to the IMF. Section VI provides an overview of the various means used by the opponents of the IMF funding increase to influence the policy debate. Section VII offers some concluding remarks.

II. A Brief History of the IMF and Its Legislative Trials

The IMF was established along with the World Bank and the General Agreement on Tariffs and Trade (GATT) at the close of World War II. The World Bank was to assist the recovery of the war-ravaged economies of the world while GATT was to ensure an orderly and rapid development of world trade. The IMF was intended to develop and enforce "an orderly code of conduct in international trade and financial matters." The IMF adopted a code that aimed at stable exchange rates with adjustments beyond some flexibility range restricted to situations where a "fundamental disequilibrium" had occurred. The IMF was prepared to extend financial assistance when necessary to ensure that a nation was able to adhere to these policies "while correcting or avoiding payment imbalances." In effect the IMF was to manage a world system of fixed exchange rates.[2]

The belief that this management function was necessary and should be performed by a political organization rather than the market was automatic. At that time the prevailing wisdom held that government

[1]For confirmation of this view, see Madison (1983).

[2]This review is based in part upon Hooke (1982).

involvement was essential to economic development. Peter Brimelow (1983) recently characterized that mood:

> The fundamental assumption underlying the IMF is that free markets can be improved by enlightened intervention. At the time of Bretton Woods [1944] this assumption dominated virtually every aspect of economic policy. Now international economics is one of its few unchallenged refuges.

Since 1944 much has been learned about the stability of the market and the efficacy of government intervention. Many policy analysts—and even some economists—are beginning to appreciate the strengths of the market. Moreover recent empirical work on the effectiveness of governmental regulatory agencies has provided a more realistic assessment of the ability of political institutions to outperform the market.

In any event these early rationales for the IMF were considerably weakened when the world went to market-determined, or floating, exchange rates in the early 1970s. These changes, according to Milton Friedman (1983a, p. 72), eliminated any need for the IMF: "It really has no reason to exist. But, of course, no government or international agency ever goes out of existence, if it can help it." Friedman went on to note that the IMF has increasingly come to see itself as the "world central bank." The existence of an IMF ready to reverse or delay market changes in exchange rates undermines the ability of the market to play its financial stabilization role. Evidence for such concern arises from government attempts to regulate housing and energy prices over the last several decades. For obvious political reasons, government is poorly equipped to substitute for the market.

Logic notwithstanding, the IMF did indeed survive and continue to lend. The rationale for a continued role was that IMF lending "facilitated" exchange rate adjustments. Thus, although the market would determine exchange rates, IMF lending would moderate the rate and extent of these adjustments. That the experts of the IMF would prove superior to the market in managing exchange-rate fluctuations was viewed as self-evident.

In other areas relating to the IMF, however, conventional wisdom was being questioned. The IMF's difficulties with the U.S. Congress first began in 1978, when the IMF sought approval of a new temporary lending authority—the Supplemental Financing Facility. During the floor debate, Congressman Thomas R. Harkin (D–Iowa), a human-rights advocate, introduced successfully an amendment that would have prohibited IMF lending to any nation that violated the human rights of its citizens. After that provision was struck from the bill in the Senate, though, Harkin voted against the measure and persuaded some 25 other congressmen to follow his lead. The IMF did obtain its supplemental financing, but it also became a topic of legitimate debate.[3]

In 1980 the IMF returned to Congress to request a permanent quota increase. The House had moved right since 1978, and this time a group of fiscally conservative congressmen joined with Congressman Harkin to oppose the increase. During the debate, Congressman Harkin (1981) sent out a "Dear Colleague" letter to some 50 liberal congressmen, which led off with the question "How would you like to cast a fiscally conservative vote and feel good about it?" The letter identified the IMF as the opportunity for such a vote and asked each of the addressees to oppose the increase. Other opponents of the increase included such tax-reduction advocates as Congressmen Andrew Jacobs, Jr. (D–Ind.), as well as such Republican house leaders as Jack Kemp (R–N.Y.) and then-Congressman David A. Stockman (R–Mich.). Stockman (1980) noted:

> This [the IMF quota increase] is bad legislation. . . . [P]roponents argue that the IMF needs this increase to help prevent economies in the Third World from collapsing under the burden of excessive external debt. . . . But the IMF does not have a record of success in strengthening unstable economies in the Third World. Indeed it has been counterproductive.

Fiscal conservatives viewed the IMF as a poor manager of international credit and sought to block the increase. Conservatives thought the economic rights of the citizens of the world should also receive protection. Although Congress nevertheless approved the IMF increase, the margin of victory was substantially reduced. The IMF bill won by 199 to 151, a difference of only 48 votes. Defeating the IMF began to look like a feasible objective.

The 1980 electoral victory of the Reagan campaign suggested greater difficulties for future IMF funding. IMF critic David Stockman was given the key role of director of the Office of Management and Budget (OMB). In addition President Reagan's initial remarks on the topic (1981) suggested a difficult time for any new IMF funding proposal: "[U]nless a nation puts its own financial and economic house in order by providing economic incentives and commercial opportunities, no amount of aid will produce progress."

This emphasis on the domestic policies and institutions of a nation was novel and significant. Reagan's identification of private property, entrepreneurial profits, and market freedoms as essential prerequi-

[3]The 1980 IMF policy debate description is based on discussions with Mark Hulbert who participated in that debate. See also Hulbert (1983).

sites to economic growth boded ill for the IMF, since the established policy of the IMF had been to treat as irrelevant a nation's economic policies. It was inevitable of course that the IMF would have maintained such a neutral position, because many of the IMF members were fervent supporters of planned economies, opponents of private property, and so forth. Nonetheless the president's words suggested that he viewed such neutrality as suspect and thus that he would question any effort to expand the IMF's role.

Nor did the Reagan administration abandon this position immediately. According to an account in the *Wall Street Journal* (Pines 1983), Treasury Secretary Donald Regan remained opposed throughout most of 1982 to any increased IMF funding. During this early period, Regan argued that any move to expand IMF funding would only encourage lax lending. His shift in attitude was apparently triggered by the Mexican financial crisis of the autumn of 1982. Regan and others within the administration may well have realized that the IMF had encouraged the Mexican problem, but they were not willing to face the economic and political consequences of allowing the market to resolve the problem.

For whatever reason, the administration did shift decisively. By September 1983, in the midst of the IMF debate, President Reagan (1983) was enthusiastically endorsing the IMF as the "critical linchpin of the world economy," even though he continued to caution that in the absence of responsible domestic policies, "all the aid in the world will be no more than money down the drain."[4] However, only the rhetorical elements of the original policy had been preserved. The IMF had neither the ability nor the will to critique the institutional arrangements of the debtor countries. Socialism might be a major cause of world poverty, but the IMF was not the agency to communicate that fact.

The IMF legislative debate occupied the period from April to November of 1983.[5] In early April the Senate authorized increased IMF funding by a vote of 55 to 34. When the bill reached the House, where opposition to the IMF had always been greater, the debate intensified. By July the efforts of the Citizens' Coalition Against the IMF Increase—an ad hoc working group of environmentalist, church,

[4]In his remarks to the IMF/World Bank leadership on 27 September 1983, President Reagan said: "It [American aid] must be considered a complement to, not a substitute for, sound policies at home. If policies are sound, financing can be beneficial. If policies are irresponsible, all the aid in the world will be no more than money down the drain."

[5]This chronology is taken from the author's own involvement in the IMF policy debate supplemented by the daily accounts of the period in the *Wall Street Journal*, *New York Times*, *Washington Times*, and *Washington Post*.

conservative, taxpayer, and free-market organizations—had begun to threaten the prospects for enactment of the measure. In response the administration mounted a major legislative lobbying effort, and in August it succeeded in persuading the House to enact a compromise authorization bill by the narrow vote of 217 to 211. The 48-vote margin of victory in 1980 had been slashed to a scant 6-vote cliffhanger in 1983.

But even then the fight continued, for Congress still had to reconcile the Senate and House versions of the bill. Moreover two additional problems emerged. First, over the opposition of the administration, the House bill had been amended to prohibit IMF loans to communist nations. Republican activists had noted that vote and had sent letters to selected voters in some of the districts where Democrats had voted against that provision. Congressman David R. Obey (D–Wis.), among those targeted, was angered by this move and he promised to block any IMF approval until the White House made it clear that his vote had the backing of the administration. A second problem emerged when Congressman Fernand J. St. Germain (D–R.I.), chairman of the House Banking Committee and an IMF supporter, decided to link any further action on the IMF legislation to passage of a housing bill. Housing legislation had been deadlocked for a number of years and had not been looked upon favorably by the administration. The administration's obvious desire for an IMF bill made it vulnerable to such logrolling tactics.

The administration, however, eventually finessed the anticommunism issue with a conciliatory letter and caved in on the housing bill. The combined bill was a "procedural mess" but did succeed in attracting enough votes in the Senate and House to gain approval. The linkage of the IMF increase to the housing bill made the final vote impossible to compare with earlier IMF votes. Senator Gordon Humphrey (R–N.H.), however, was able to force a vote on one floor amendment to reduce the IMF funding level. That amendment was defeated 52 to 45, which suggested further erosion of IMF support within the Senate.

The final IMF bill includes little substantive reform; thus its supporters can legitimately claim an impressive victory. The trends, though, suggest that the "good manager" image of the IMF is weakening rapidly. Moreover, as noted in a postmortem report in *The Economist Financial Report* (1983), "The damage has been done; it [the emergence of major opposition to the IMF] has cast doubts about the American interest in international affairs." While the view that a reduced government presence in the world economy amounts to neoisolationism should be rejected, the general tenor of the remark is accurate. Proponents of government-dominated foreign economic assistance have much to worry about.

III. The Political Nature of the IMF

That the IMF's fate has rested with the political process has been totally appropriate, for the IMF is itself a political institution. It is managed by politically appointed individuals from member nations, and the political interests of its members influence its decisions. Within this framework the general functioning of the IMF is straightforward. A debtor nation calls upon the IMF when it discovers or anticipates a foreign-exchange shortage. This shortage may have resulted because of some exogenous shock to that nation's economy—an increase in the price of energy, for example, or a sudden drop in the price of one of its key export commodities. Or it may reflect careless or wasteful governmental policies. Whatever the reason for the shortage, the IMF then sends a mission to determine what steps the nation should take to regain its economic health—or more properly its ability to repay its foreign obligations. These steps are then codified in a so-called conditionality agreement. If the debtor nation accepts the management advice of the IMF, it gets a direct IMF loan; far more importantly, though, it gains access to the world's private credit markets. The IMF then monitors the debtor nation's adherence to these conditions. If problems develop—as they have in recent years with distressing frequency—the IMF threatens to suspend loan repayments. The private sector follows suit, and negotiations recommence.

Why Do Politicians Accept Such Conditions?

The leaders of the debtor nations accept such conditions because, to date, they have found it in their interest to do so. Developing nations need access to the private credit markets of the world. The banks and other financial institutions of the developed world supply the capital necessary to finance development in the Third World. This fact is of course not new. The developing United States, in an era without the IMF, benefited by being able to borrow from the British capital markets. In today's world, however, the IMF controls access to the capital markets for most developing nations facing financial difficulties. Private lending institutions avoid lending to debtor nations lacking the IMF seal of approval.

This approval role means that most of the moneys made available as a result of IMF involvement are provided directly by private-sector lenders. Moreover the IMF leverages its resources by "encouraging" private lending institutions to grant loans. As a result only a fraction of the funds flowing to a debtor nation as a result of the IMF's involvement are channeled through the IMF. The major value of the IMF is thus providing access to the private capital markets—providing its seal of approval, not engaging in direct lending.

Why Do Banks Accept the IMF Decision?

Private lending institutions have to date accepted the IMF's seal of approval because they believe such approval makes it likely that further lending will prove profitable. The financial institutions might reach this conclusion because either they believe the IMF is insuring the loans, or they believe the IMF has credibly determined that the prospects for repayment of the loan justify further lending.

Only the second reason provides an acceptable role for the IMF. Nor do IMF proponents argue the first reason. Most economists recognize that an IMF loan-guarantee role would threaten the world financial system. Loan guarantees have long been recognized as risky public policy, in that they reduce the incentives to select and manage projects successfully. Nonetheless IMF critics, such as Congressman Henry B. Gonzalez (D–Tex.), have suggested that the IMF is playing exactly this role. Gonzalez, in a press conference organized by the coalition, noted that the IMF has become an "international FDIC for banks."[6]

An explicit or implicit IMF loan-guarantee role would endanger the stability of the international financial system. The function of the banking industry is to allocate funds to valuable purposes while taking into account the actual risks, costs, and benefits involved. If a financial institution believes that its own risks are reduced by the IMF, it is likely to commit resources to purposes that will fail to realize an adequate return. Resources will be diverted to subsidized risk areas and diverted from areas of higher social return. The waste inherent in such an imprudent loan policy is serious in our own domestic economy; thus loan-guarantee programs are receiving increasing scrutiny in Congress. Such imprudent loan policies, however, are far more serious in the Third World. The United States is a

[6]The analogy between the IMF and the FDIC is highly appropriate. Both illustrate cases in which political institutions have attempted to manage inherently risky situations by substituting centralized guidance for individual responsibility. In each case the central authority seeks to manage the risk by imposing regulatory restrictions, while simultaneously guaranteeing that no one will be held liable if the situation deteriorates. Such no-fault schemes socialize the risks of domestic and international lending and borrowing and thus create major "moral hazards." The thrust of this paper is that both the FDIC and the IMF act to destabilize their respective financial systems. See Vaubel (1983).

rich nation, where wasted resources imply "only" lower growth rates and reduced standards of living. The Third World is poor, and encouraging imprudent lending there means higher death rates, malnutrition, and destroyed dreams.

Thus the only defensible reason for the banks accepting the judgment of the IMF is their belief that the management program developed by the IMF is likely to increase the ability of a debtor nation to repay its debts. The critical role of the IMF, therefore, is to provide accurate credit assessment. Unfortunately this function is compromised by the IMF's lending role. To see this, it is useful to compare and contrast the credit-rating performance of the IMF with that of private credit-rating agencies, such as Standard & Poor's or Moody's.

IV. The Private Sector Analogy: How Standard & Poor's Manages

The credit-appraisal function of the IMF resembles the similar function played by such U.S. private-sector firms as Standard & Poor's (S&P) or Moody's (Smith 1983). These firms also provide credit-rating or seal-of-approval information on political entities, including cities, states, and even selected foreign nations. Private lending institutions use these ratings to determine interest charges and credit availability. Unlike the IMF, however, S&P is a private firm rather than a political entity, and it does not lend. As noted below, these factors arguably improve its effectiveness.

To see this, consider the problems that could arise if S&P were brought into the political system, say, as an arm of the Treasury Department. Political difficulties would be inevitable. Democratic administrations would be accused of favoritism by Republican mayors and vice versa. A nonpolitical, private-sector S&P avoids such problems for a very obvious reason. Like any private-sector firm, it must sell its product—in this case its credit ratings—to survive. S&P, unlike the IMF, must meet a market test. If S&P loses its reputation for objectivity, it will have nothing to sell. In contrast the IMF faces no such market discipline. The IMF professional management staff may well make objective recommendations, but that does not mean that these recommendations will survive the decisions of the board of governors. It is not surprising therefore that the IMF has been widely charged with political bias regarding its loan decisions to such nations as South Africa and Nicaragua. A nonpolitical IMF would be far more likely to provide objective information, rather than information tempered by the political agendas of its leading managers.

The IMF's lending role creates an equally obvious problem. Suppose S&P had to rate the bonds of New York City while at the same time it held a quantity of such bonds in its portfolio. S&P would have a strong incentive to avoid any downgrading that would reduce the value of its own holdings. Instead it would be tempted to work with city officials to arrive at what would be called a sound economic program for gradual recovery. Naturally city officials would take advantage of S&P's conflict of interest to argue against any severe readjustment. They could well argue that city salaries and public works spending must continue to increase for some period. S&P would thus be subject to the same type of political blackmail that the IMF undergoes. The credit-assessment role directly conflicts with the lending role.

This possibility was raised recently by Fred Bergsten, director of the International Institute of Economics and a strong supporter of the IMF (1983): "Traditionally the Fund has gone in and out, like a revolving fund, . . . over a period of one to three years. I don't think that's possible now. . . . It [the Fund] is kind of locked into the countries where it has put a lot of money. . . ." The political tightwire acts that have characterized the recent negotiations between the IMF and Brazil, Argentina, and Mexico indicate the extent of this conflict. On the one hand the IMF wishes to be objective, while on the other hand the IMF's own finances are heavily linked to the prospects for these nations. Indeed, if the IMF continues to renegotiate its agreements under pressure, banks will come to doubt the objectivity of any IMF seal of approval. In such cases banks may come to ignore the credit-assessment role of the IMF and respond only to its implicit loan-guarantee role. If that happens and banks come to believe that the IMF will protect their loans, no matter how imprudent, the percentage of bad loans granted will increase and this will further exacerbate the plight of debtor nations.[7]

[7]The dangers outlined in this section have largely come to pass since this paper was first prepared. Argentina first balked at repaying its loans and the U.S. Treasury designed a jerry-built rescue scheme involving Mexico, Brazil, Venezuela, and the United States to "save the situation." Having learned that blackmail works, Argentina then elected not to meet a payment schedule. Under existing U.S. banking regulations, this action would have made Argentina loans nonperforming and thus would have required that they be removed from the asset sheet of the lending U.S. bank. In turn this would have led to a substantial change in the apparent profitability of such loans and thus a reduction in the stock value of the respective banks.

The U.S. Treasury, driven by desire to ensure against creating any problem for large banks, simply changed the deadlines for repaying such loans under the pretense that Argentina would soon reach agreement with the IMF over conditionality terms that would allow repayment again. Argentina responded as one might have imagined by

S&P Provides a Far More Sensitive Credit Appraisal Function

One area where the superiority of the S&P model is dramatic is in providing a much greater level of data than does the IMF. The IMF gets involved only when a nation is in dire straits, and then it provides only two ratings: the nation either is or is not eligible for private-sector lending. This makes it extremely difficult for the IMF to enforce its decrees. Minor infractions would scarcely seem to justify termination of payments and yet enough minor infractions would undermine the conditionality agreement. S&P in contrast, uses a 20-tier rating system with credit availability and interest rates varying accordingly.

This early-warning information role is not as exciting as *Perils of Pauline* rescue missions, but the case for preventive medicine would seem especially strong for Third World Nations. To continue the current IMF approach seems particularly unfair to the peoples of the Third World. The leaders of U.S. political entities having resources adequate for relatively large policy adjustments are notified at once of any threat to their credit rating. In contrast the IMF allows debtor nations to proceed merrily along and enters the scene only when the economies of these nations are near collapse and require major and rather costly adjustments. A private sector model would seem far more merciful.

S&P Leaves Politics to the Politicians

The private sector realizes that certain functions are best handled independently. Thus the S&P, unlike the IMF, does not attempt to assume the politicians' role. S&P does not dictate any recovery plan. S&P is well aware that mayors have available a wide range of professional consultants if they wish to obtain advice. Of course S&P is prepared to discuss the basis of its judgments and to revise its ratings if conditions change or if a city elects to change its policies, but it does not presume to set the priorities of the political jurisdiction. In contrast the IMF plays a far more activist role. Indeed the IMF claims to be the credit doctor that can make sick nations well. This meddling with the political affairs of sovereign nations is dangerous; most

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raising the stakes, and it is now (summer 1984) apparently succeeding in softening the IMF's initial conditionality terms.

Contrast this highly political, highly arbitrary process with the recent decision by S&P (15 June 1984) to place on notice the state of California that a proposed tax-reduction plan might reduce the state's credit rating. The difference between such automatic nonpolitical objective assessment of the S&P and the political capriciousness of the U.S. Treasury/IMF negotiation process is striking.

political entities are extremely jealous of their sovereign status. Moreover such meddling provides many opportunities for the patient to coopt the doctor.

How Effective is the IMF as a Credit Doctor?

The IMF as a doctor does not seem very successful. Roland Vaubel (1983) has noted in his article on "The Moral Hazard of IMF Lending" the danger that the IMF in standing ready to assist nations that get into difficulty increases the likelihood that such difficulties will occur. To reinforce this point, Vaubel (p. 65) cites Wilson Schmidt, the individual in line to head the World Bank at the time of his tragic death: "It can be argued that, absent the Fund, individual countries would presumably be less likely to get into balance of payments difficulties because they could not rely on the prospect of Fund resources when those difficulties arose."

Vaubel also noted some disturbing statistics, such as that the IMF has a low cure rate; indeed, if the IMF were viewed as a credit rehabilitation program, the repeated offense record of its clients would raise many questions. A minority of the membership of the IMF accounts for most of the recurring loan requirements, a pattern that would not be expected to occur if financial mishaps were random. The IMF appears to have created a class of permanent bad-credit nations that have grown accustomed to its emergency assistance.

A New Private Initiative

Market alternatives to the IMF should have received far more attention in the recent congressional debate. They did not in part because few legislators really understood the operations of the IMF and its alleged rationale, while those people in the administration knowledgeable about the IMF and its problems had become committed to the IMF increase. Those within the administration who favor reforming the IMF, at least in the longer run, are likely to find it far more difficult to gain an audience for reform in the absence of any crisis.

Perhaps this view is too pessimistic. The world's financial managers have long recognized the lack of information on the loan status of nation states not yet in dire straits. Efforts to have the IMF move into this area have proved unavailing. Thus the banking community recently created the Institute of International Finance, Inc. (IIF). Its interim chairman, William S. Ogden (1983), has outlined three tasks: (1) to gather and make available economic information on debtor nations, (2) to monitor the credit status of such nations and offer economic advice selectively, and (3) to recommend measures to improve international lending. These tasks suggest that the IIF may well resemble the S&P model discussed above. Ogden emphasizes that the initiative was taken by the private sector in response to the needs of the industry. A private S&P may therefore exist regardless of the eventual fate of the IMF.[8]

V. The Political Framing of the Issue

Private credit-assessment alternatives received little attention in the actual political debate. Instead the supporters of the IMF successfully framed the debate in terms of an emergency response to the international debt crisis. This framing of the IMF quota increase encouraged fence sitters to vote for passage. The key argument, and the one that proved most effective, was that failure to enact the IMF quota increase threatened the safety and soundness of the world financial system. Although IMF opponents, including Milton Friedman and Robert Weintraub, succeeded in raising many questions regarding the overall wisdom of the IMF, they were unable to overcome the view of many regulators that the costs were low and the risks, even if very low, justified the price tag. After all $8.4 billion is not a major commitment in the Washington scale of things, and no one wanted to be responsible for *Götterdämmerung*. Daily stories about the international "debt bomb" carried the day.

Moreover the proponents successfully used the humanitarian theme that has long legitimized foreign aid. Although always careful to note that IMF assistance was not "aid," they nonetheless argued that the increase was essential to prevent further suffering in the Third World. The *Washington Post*, in an especially moving editorial (1983b), noted that Brazil's difficulties stemmed from a desire to "lower infant mortality rates" and went on to note that one should vote against the IMF increase only "if infant mortality rates don't concern you. . . ." Statements such as these made it extremely easy for the traditional supporters of humanitarian assistance to see the IMF question as simply one of help to the needy and thus deserving of support.

A final argument of major political effectiveness if not quite of the same high moral order was the claim that IMF assistance created

[8]There remains considerable uncertainty about the exact role that this new group will play. Ogden (1983) seems to suggest an active role in providing information; however André de Lattre, the first head of the IIF, stated (in Baird 1983) that the IIF "will not be a negotiating body between the banks and the borrowing countries and it will not be a rating agency." This ambiguity will be resolved only as the IIF defines its functions over the next several years.

wealth in the United States. The "jobs-and-money" rationale for government spending is of course used to defend every government program; nonetheless it has an obvious political appeal. Government income-transfer programs do redistribute wealth, and the recipients are often willing to support legislators who favor such transfers. The IMF transfers to foreign governments do allow some U.S. interest groups involved in trade with those countries to benefit. Thus large numbers of firms outside the banking industry did support the IMF increase. An advertisement entitled, "Pass the IMF Bill," that appeared in the *Washington Post* (1983c) in the closing days of the debate was signed by a list that read like a who's who of big business in America.

Many of the arguments advanced in defense of the IMF, however, did not necessarily support an IMF funding increase but rather supported the continuation and improvement of the IMF's credit-assessment and credit-advisor role. Let us consider these points.

The IMF: Essential to World Financial Soundness and Safety

The most effective single strategy employed by IMF proponents was what may be called the fear theme: Vote for the IMF or the financial world will collapse. Newspapers were filled with talk of the international debt crisis and editorialists predicted "debtor OPECs" and similar default scenarios. One of the more extreme statements was that by James D. Robinson III, chairman of American Express (in Brimelow 1983). In a reference to those who might oppose the IMF funding, Robinson said:

> I'd like to know how many able-bodied men between the ages of 18 and 24 they have in their community and what size boots they wear. I'd tell them to get ready to go to Latin America, because you let some of those governments go populist and you're going to have national security problems.

In a similar vein, the managing director of the IMF, Jacques de Larosière, noted (1983) that failure to approve swiftly the IMF increase would "cripple this institution . . . [with] incalculable consequences for economic and financial stability worldwide."

Several attempts were made to introduce a note of rationality into this debate. Perhaps the most notable attempt was that made by the late Robert Weintraub, senior economist for the Joint Economic Committee. His monograph *International Debt: Crisis and Challenge* (1983a) provided IMF opponents with a valuable tool for educating legislative staff. Weintraub argued that the fears associated with the debt crisis had been vastly overblown, that painful adjustments were inevitable but should be borne by those directly involved and not the American taxpayer, and that the best solution would be to avoid any permanent increase in the IMF's resources. Banks might well reschedule loans, but that decision should be left to the market. Weintraub did see a temporary lending role for government bodies, but no permanent increase seemed necessary.

Weintraub's monograph had some impact, but the issue was sufficiently complex and the timing rushed enough so the message was not heard effectively by most legislators. Weintraub unfortunately became ill during the summer and later died, thereby removing a major spokesman for logical reform from the scene. His second monograph, *International Lending By U.S. Banks: Practices, Problems, and Policies* (Weintraub 1983b), was published just before his death and provides a useful basis for future reform efforts.

Other critics also argued persuasively that a financial crisis would not occur in the absence of increased IMF funding. Roland Vaubel (1983, pp. 73–74) made the point early in the policy debate and it was often repeated by the Citizens' Coalition Against the IMF Increase. The coalition addressed a number of specific arguments used by proponents of the IMF funding increase and demonstrated that these arguments were mostly fallacious. The first set of arguments addressed by the coalition dealt with the following four points.

1. *IMF Lending Is the Only Way to Address Liquidity Problems.* This argument is not convincing. After all, private lenders and their debtors already have every incentive to avoid default. Banks have no reason to reduce the economic value of their foreign loans any further than necessary. Debtors have every reason to avoid being cut off from world financial markets, in that their future financial prospects require foreign capital. What does the IMF add to this situation? Arguably the IMF merely makes it easier for both sides—and Third World political leaders—to delay the difficult adjustments that bad management or unfortunate circumstances occasionally make necessary. Easy credit creates a moral hazard, as discussed earlier. Any effort to protect nations from the consequences of adverse balance-of-payment adjustments increases the likelihood that such problems will occur. Empirical evidence that this possibility is actually occurring is provided in Vaubel (1983).

2. *IMF Lending Stabilizes a Floating Exchange World.* As Milton Friedman said, there is no obvious role for the IMF in a world with floating exchange rates. If each nation was to allow its currency to fluctuate freely against other currencies, then each nation would have a strong incentive to adjust its behavior in the proper direction. In such a world there would be no foreign exchange crises. External factors such as oil price increases and internal events such as droughts

or monsoons, as well as policy errors, would affect exchange rates automatically—a nation would experience feedback signals at once that would encourage it to make the necessary corrections. In this world there would seem to be no need for the IMF lending role.

IMF proponents, however, suggest that the IMF should play a more critical role in stabilizing exchange rates. In principle such stabilization efforts, if they were successful, would be extremely valuable. Prices that fluctuate unnecessarily are of course costly. Firms and financial institutions have great incentives to take whatever steps they can to reduce these fluctuations. There are a number of alternative approaches, though, to a world central bank: private borrowing to moderate exchange rate fluctuations, adjustable equity participation rates depending upon exchange rates, or entering the futures markets in some convertible currency to hedge against fluctuations in exchange rates. The ready availability of IMF lending discourages these self-help alternatives.

3. *IMF Lending Sweetens the Conditionality Agreement.* Proponents argue that the IMF must lend to provide the incentives for foreign nations to agree to the conditions. This argument ignores the fact that most of the leverage possessed by the IMF arises from its gatekeeper role with respect to private lending. It is the leverage, not the direct lending, that persuades nations to listen to the IMF. Moreover an IMF conditionality agreement either is or is not justified in its own right; the use of an upfront sweetener is all too likely to encourage politicians to delay painful adjustments. One is reminded of the sinner in a small boat in a storm, praying to God that if he was saved he would give up his wicked ways. But when out of nowhere a ship appears, he calls out, "Wait a minute, I think I'll be O.K." Third World politicians, like most politicians, would prefer to delay pain. IMF lending makes that possible.

There is also something distasteful about the propriety of sweetener loans, as though Third World leaders would not do what was best for their nations without side payments. Providing what might readily be seen as a bribe may cause many more problems over time. Finally sugarcoating says a lot about the attitude of IMF officials toward Third World leaders—that the leaders are kids who do not know what is good for them and thus need the "grandmotherly" guidance of the IMF staff. Politicians of course are far more likely to gain advantage from that situation than are the IMF staff. The IMF is already attacked in the world financial community as being too paternalistic, and thus feels the need to avoid being too prescriptive.

4. *IMF Lending Reduces Political Instability.* Equally unconvincing is the argument that without increased IMF funding to allow

banks to continue current lending practices, Mexico and other large debtor nations are likely to collapse. This argument is disingenuous. It is the IMF austerity conditions that have proven so controversial and politically destablizing, not the more gradual and flexible arrangements that develop naturally between banks and their debtor. Arguably the current IMF policies actually encourage political instability. Certainly IMF policies encourage greater and greater levels of international debt, and the quantity of international lending seems far more important to the IMF than the quality of that lending.

Indeed the current crisis results in part from the availability of IMF financing. External shocks or internal mismanagement create a need for painful adjustments, which, however, can be deferred because of the availability of IMF financing. Delay merely increases the magnitude of the eventual adjustment and increases its pain. Eventually these costs will be experienced. As the IMF encourages central resolution of these questions, the pain will almost certainly fall disproportionately on the politically less powerful. The virtue of having the poor bear the brunt of economic adjustments seems unclear.

Moreover, as noted earlier, the S&P model would suggest that nations be put on the alert much earlier that their policies or external events are leading them into difficulties. The IMF practice of simply classifying a nation as being in one of two classes—worthy of credit or not worthy of credit—is far more crude than we would expect if the function were privately managed. Moreover the austerity conditions themselves, while perhaps economically sound, are clearly externally designed and mandated, a situation that creates major political problems. Those problems are likely to be greater than had the adjustments been designed and administered internally.

Indeed the value of conditionality agreements is subject to major challenge on still another grounds. In effect the logic of a conditionality agreement is that some means can be found to improve the efficiency of any nation state regardless of its institutional arrangements regarding property and profits. That belief is well-founded in the so-called scientific socialism literature, but it has been effectively criticized in the work of F. A. Hayek (1978) among others. As noted earlier the details of a recovery plan are far less important than the existence of an incentive structure that encourages wealth-producing activities. Conditionality plans ignore institutional arrangements and instead establish goals for the nation as a whole to meet. But why should institutions that are reluctant to modify their behavior even when faced by crisis conditions be more ready to do so after the IMF has reduced the level of the crisis?

In conclusion the argument that the financial system of the world would be endangered without increased IMF funding was not particularly convincing. The coalition was able to muster considerable expert opinion that a collapse was an extremely unlikely option and would be made far more likely by the continued machinations of the IMF. Nonetheless the lingering uncertainty in the minds of many legislators made the "collapse" argument particularly effective, and the conventional remedy was to spend more money.

Humanitarian Arguments for the IMF Increase

Foreign aid has long enjoyed support for its humanitarian objectives. Although IMF proponents are quick to note that the IMF assistance is not aid but rather loans that are repaid, they believe nonetheless that without the IMF the plight of the Third World would be far worse. According to Michael K. O'Leary in his book *The Politics of American Foreign Aid* (1967), Americans support foreign aid to the extent such aid (1) is seen as exporting the "American way of life," (2) can be viewed as basic humanitarian relief, (3) supports allies, and (4) entails a relatively low level of involvement. Americans oppose foreign aid to the extent that the aid supports unfriendly ideologies, nonallies, and wasteful, nonpeople-related projects, and requires a deep involvement abroad.

Both IMF proponents and opponents succeeded in different ways in emphasizing these contradictory themes in the 1983 debate. As noted earlier, the *Washington Post* continuously linked the IMF decision to the plight of the Third World and characterized IMF opponents as callous and indifferent to humanitarian concerns. In contrast, opponents of the IMF increase emphasized past loans of the IMF to communist nations or South Africa, depending upon the audience being addressed.

The criticisms of foreign aid as impoverishing rather than aiding the poor have yet to have any significant impact on traditional supporters of foreign aid. P. T. Bauer's suggestion (1981b) that the term "aid" "disarms criticisms, obscures realities, and prejudices results" remains true. Foreign aid continues to be judged on its intent rather than its performance. The IMF debate provided an initial effort to educate interest groups on the problems associated with such aid programs, and this effort will continue. Proponents offered a number of supporting arguments that stemmed from this foreign assistance theme. These arguments are discussed below.

1. *Private Capital Markets Won't Lend Enough.* This argument is suspect. As noted the IMF is not meant to be a foreign aid agency. It is intended to provide only short-term assistance to nations suffer-

ing reversible liquidity problems. As such the only lending it should do is that which makes economic sense. If the IMF's assessment of a nation as credit-worthy is objective, why should not all the lending be through private banks? As noted, most of such lending already proceeds in this way. Those critics who reject the market solution seem to do so only because they do not like the answer it gives. They believe that political institutions will lend more, so they favor that approach. Their preference for the IMF encourages risks that would not be sustained in the market and needlessly increase the vulnerability of the U.S. financial system.

2. *IMF Lending Creates Job Opportunities for Americans.* Rationalizing dubious public policies on the grounds that they create jobs has replaced patriotism as the last refuge of a scoundrel. The IMF program, like any program that transfers wealth, will increase employment in some industries at the expense of others. If IMF aid is effective at maintaining U.S. exports, then employment will expand in these industries at the expense of reduced employment in industries that gave up the capital used to finance the IMF expansion. Moreover, even in the area of job transfers, the IMF program does not acquit itself very well:

- Foreign trade is important to the United States, but the amount of foreign trade at risk even in the worse-case analysis (an extremely unlikely scenario) would affect only a fraction of such trade. According to a statement by Senator Gordon Humphrey (1983), total curtailments of all imports by the leading Latin debtor nations—Brazil, Argentina, Chile, Mexico, and Venezuela—would reduce the U.S. gross national product by less than 1 percent. Not only is that outcome extremely unlikely, but moreover, as noted below, curtailed foreign markets for U.S. products is made likely by IMF policies.
- As William Simon (1983) has noted, sending more money abroad to create jobs is akin to a shopkeeper throwing money out of his store window in the hope that some passerby will find the money, pick it up, and buy something. There are far more effective domestic options that would yield a greater return—education, public works, investment loans, and so forth. Also domestic subsidies are far more likely to be spent in the United States.
- The IMF, like any lending institution, is concerned more with ensuring that the debtor's cash flow allows him to repay the loan than with any long-term growth objective. This amounts to a strategy of buy less, maintain less, invest less, and sell more. Such policies are good for the lending institutions but

may not be good for the nations, and they certainly result in an immediate reduction in markets for U.S. goods and greater competition for U.S. exports in the world market. In effect if not in principle, the IMF's policies encourage protection. This is destructive in itself; moreover the policy cannot be sustained worldwide. It is impossible for all nations simultaneously to curtail imports and expand exports (Meltzer 1983b, pp. 7–8).

- The only way to attain sustainable growth in world trade and thus sustainable increases in U.S. trade-related employment is to encourage prudent loans that create real wealth growth in the Third World. Such growth is indeed important for increased trade and expanded U.S. exports. IMF practices, however, make such productive lending less—not more—likely by rewarding those who promoted past bad loans.
- Public policy analysts know well how often the jobs argument is used to justify various government pork-barrel projects. Its use in the IMF funding case is indicative of the weakness of any case for increasing IMF funding.

3. *IMF Lending Is Free.* The claim that IMF funding is free is again unsupportable. There is no free credit available in our economy. Our current budget accounting rules do allow the costs of IMF funding to be hidden off-budget, but that is a policy questionable in its own right and one that has been permitted only in the last 15 years. Regardless of the budget treatment, though, increased funding of the IMF diverts funds from the U.S. capital markets. The resulting lower capital availability translates directly into higher interest rates and creates problems for small businesses, farmers, and consumers.

4. *The IMF Provides a Convenient Scapegoat for Necessary Reforms.* The argument is that the IMF provides the politician with an external devil to blame while he undertakes the necessary reforms. This argument raises many questions; for instance do we really wish to encourage Third World nations to believe any more than they now do in the exploitation thesis, whereby their poverty is caused by our wealth? At a recent conference Sir Alan Walters (1983, p. 70) noted that many see the IMF as "a convenient scapegoat," but one largely controlled by the United States. Resentment against the IMF becomes resentment against the United States. In any event the scapegoat role does not require that the IMF lend. Banks and Third World countries can lambast the IMF in its seal-of-approval role without having the IMF lend anything.

5. *The United States Must Increase Its Quota Contribution for Leadership Reasons.* The United States would not lose prestige by

moving to challenge the IMF's lending role. Foreign nations are unlikely to extend credits to the IMF if the United States elects to drop its commitment.

6. *The IMF's Information-Gathering Role Is Essential.* Whether the IMF is more likely to provide quality data than a private-sector firm is questionable. The IMF's information-gathering role can readily be separated from its lending role. Indeed the emergence of The Institute of International Finance suggests that the IMF has failed to provide all the required information in a timely manner.

7. *Only the IMF Can Enforce Conditionality Agreements.* This proposition, as discussed above, is dubious. Even if one accepts it for argument purposes, it does not justify the IMF lending role. As noted the leverage of the IMF results primarily from its ability to attract or deter private investment. That leverage is strengthened, not weakened, by reducing its lending function.

Specific Arguments Against the IMF Increase

In addition to refuting the arguments favoring the IMF funding increase, the coalition raised the following three arguments against the increase.

1. *Trade Objections to the IMF Increase.* One issue raised by Senator Humphrey (1983) deals with the advisability of providing U.S. assistance to foreign nations to finance industries in competition with our own domestic industries. This issue is an important one and bears on the overall question of the undue reliance on "official" or "government-to-government" foreign aid. Many of the developing nations have learned some bad economics, and the result has been wasteful investment in infrastructure, atomic power, steel mills, and national airlines. The attitude of the Third World seems to have been that since the United States and other advanced nations are wealthy and have such investments, all the developing countries have to do to get wealthy is to build such facilities. In many ways the Third World and its financial advisors seems to believe in a modern version of the cargo cult.

Of course we are not responsible for the stupidities of other nations, but we are well advised to minimize our encouragement of such practices. We cannot do so, though, if we encourage these actions by providing the IMF with the wherewithal to bail out any nation and its bank creditors when poorly thought through investments go sour. The Brazilians in particular have put together a history of wasteful investments that make our own bureaucracies look efficient. Now they are in trouble and the IMF is required to provide the funding to ensure that they keep going and that their banking creditors do not suffer losses. Is this logical? After all the Brazilians built steel mills that made little economic sense and then attempted to subsidize the output and provide export subsidies besides—all in an attempt to avoid the painful admission that they should never have embarked on this course in the first place.

Absent the IMF as lender of last resort, national leaders would still make foolish or unfortunate decisions, in that people are not equally competent and risk is a fact of life. Bad decisions would be less likely, however, because those involved in the decision-making process would face the full consequences of their actions. Subsidized steel or copper smelters would still arise, but far less often and without our active financial assistance.[9]

2. *The "Bail-In" Argument.* IMF proponents have argued that the IMF is not "bailing out" the banks, but rather "encouraging"—some would say coercing—them to lend more and thus increase their exposure in risky nations. This "bail-in" policy is scarcely favorable to the banks, and thus the IMF bill cannot be considered a subsidy to the banking industry. This line of argument raises a number of questions. Do we wish to encourage banks to go further than prudent lending policy would dictate in lending to nations already suffering from high interest burdens? Are we not thereby encouraging banks to take short-term profits at great risk? These risks are serious; the depositors of the banks involved in the foreign debt situations are all guaranteed by the FDIC. Thus if these banks fail, the U.S. taxpayer will be held responsible for any unfunded liability.

Of course IMF proponents believe that the risk of default is small and that if the loans are extended, the world will recover. But should we trust their judgments over those that would prevail if bankers had to make these choices directly? Banks after all are in the business of making risky investment decisions, whereas the IMF is not. Most of us find it easier to gamble with other people's money, but we rarely act as responsibly in such cases.

Moreover, although banks are indeed encouraged to place more of their funds at risk than they believe advisable, they have still been

[9]An interesting impact of the IMF on world trade was recently noted by Hugh M. Morgan, president of Western Mining Corporation of Australia. Morgan (1984) noted that the IMF's emphasis on restoring cash flow at any cost makes it sympathetic to subsidized production schemes that garner foreign exchange. Thus nations such as Zambia and Chile export highly subsidized copper at rates that displace efficient but unsubsidized Australian and U.S. production. The resulting collapse of foreign markets for the efficient producers places pressure on these nations to erect trade barriers. Thus the IMF acts to promote protectionism in the developed world as well as in the underdeveloped world. Moreover the world finds itself poorer because copper is being produced less efficiently than otherwise would be the case.

allowed large upfront rescheduling fees and permitted to treat all existing loans as if they were still worth their book value. That fiction is worth considerable amounts in that the banks would otherwise have to begin setting aside loss reserves.

3. *Big Bank Favoritism.* The IMF quota increase creates a major inequity in that foreign lending is treated differently from domestic lending. The experience of, say, the Penn Square bank compared with those banks now at risk in Mexico is a good example. In retrospect both situations reveal overinvestment in oil-related properties in anticipation of continued oil price increases. When the increases failed to happen, some of these loans became nonperforming. Penn Square was subject to normal accounting practices and went into reorganization. Some shareholders lost large amounts, as did some depositors. A painful experience, but our economy is a profit-and-loss economy and without the loss there is no likelihood of rational investment. The large money center banks that are suffering similar experiences with their Mexican debtors to date have been able to avoid similar consequences. In part this may indicate that the loans granted by these institutions were more successful, but the situation also reflects the fact that continued IMF and other U.S. lending to Mexico has allowed the Mexican creditors to continue to make their interest payments. If big institutions are not allowed to experience the same market disciplines as small banks, there is little equity in the system.

The argument that big banks cannot be allowed to fail, which has been offered by some IMF proponents in defense of this inequity, is contradicted by Weintraub's (1983a) analysis. He demonstrates that the required write-offs could take place over time and that this might well lead to shifts in banking personnel and some deposit shifts, but that none of this need lead to any major disruption in the U.S. banking system (pp. 25–34). Moreover, to the extent that one believes that big banks are too important to experience normal business losses, one should oppose further increases in their exposure—not endorse the IMF policies.[10]

VI. The Political Opposition to the IMF

In accessing any lobbying campaign, it is important to realize that cause and effect are intricately interwoven. That fact creates consid-

[10]The FDIC now appears to have adopted the Treasury/IMF line that no large banks can ever fail no matter how mistaken their policies may have been. The politics of avoiding any adjustment costs in the hopes that things will improve are now dominant in both the national and international spheres. The destabilizing impact these decisions are having on financial operations is obvious.

erable problems for those seeking to rationalize the story. A campaign is somewhat akin to a market in that the results emerge from a process far beyond the grasp of any one individual. Analysis, interest-group positions, media support or opposition, and the degree and nature of the lobbying campaign all have important impacts on the eventual outcome. Moreover such factors as personalities, logrolling arrangements, and side issues may all have more to do with the issue than the specific merits of the case. This section discusses briefly four elements of the effort of the Citizens' Coalition Against the IMF Increase to reframe the IMF debate: the effort to develop analytic material on the issue, the effort to develop and motivate coalition opposition to the measure, efforts to gain sympathetic media coverage, and finally the lobbying effort.

Analytic Background for the IMF Debate

Over the last two decades market-oriented groups have challenged the dominance of those organizations favoring government solutions. Many of these pro-market groups played some role in the IMF debate. Among the many activities and publishing events attributable to them were a joint conference by the Heritage Society and the Philadelphia Society that resulted in publication of *International Lending and the IMF* (Meltzer 1983a); a *Citizen's Guide to the World Banking Crisis* (1983) by the Conservative Caucus Research, Analysis & Education Foundation; a Cato Institute Policy Analysis on "The Causes and Risks of Excessive Foreign Lending," by Mark Hulbert (1983); the proceedings of a Taxpayers' Foundation seminar, *Constructive Approaches to the Foreign Debt Dilemma* (Hulbert and Meltzer 1983); and a public policy forum, "The Third World Debt Crisis and the IMF," organized on 7 November 1983 by a number of groups, including liberal opponents of the IMF. These educational activities were accompanied by numerous articles criticizing the IMF in various journals.

These specific IMF-targeted programs reflected to some extent earlier work by critics of foreign aid, in particular the work of P. T. Bauer. His work on the value of "official," or government-to-government, aid policies (see, for example, Bauer 1972, 1981a), and the work of Melvyn Krauss (1983), provide a convincing argument for curtailing on humanitarian grounds most existing aid programs.

The IMF debate also attracted the comments of numerous intellectuals. Nobel Prize winner Milton Friedman spoke out vigorously against the increase, as did Robert Weintraub. Manuel F. Ayau, a Guatemalan economist, noted that the ready availability of IMF financing encouraged his nation to delay necessary currency adjustments. Ayau (1983) suggested that those wishing to help the people of Guatemala should lobby for opening the United States to Guatemalan imports rather than increased IMF funding. Allan H. Meltzer, noted (1983b) that IMF policies promote protectionism by requiring all nations to expand exports and decrease imports. Sir Alan Walters, former economic advisor to British Prime Minister Margaret Thatcher, suggested (1983) that the IMF may be more the cause of the world's economic problems than the solution. The strongest element of the coalition's efforts was attracting and disseminating the arguments developed by these and other scholars.

Coalition Support and Opposition

Many public interest groups were involved in the IMF debate and most of them opposed the increase. Prominent taxpayer, promarket, and conservative groups took the lead in organizing opposition. These groups also made a vigorous effort to link up with liberal, church, consumer, and other groups. The eventual Citizens' Coalition Against the IMF Increase brought together promarket groups such as the Council for a Competitive Economy[11]; conservative organizations such as the Conservative Caucus, Free the Eagle, and Coalitions for America; taxpayer organizations such as the National Taxpayers Union, the National Tax Limitation Committee, and the National Taxpayers Legal Fund; consumer representatives, including Ralph Nader and Congress Watch; environmental groups such as the Environmental Policy Center; and activist religious groups such as the United Methodist's Board of Church and Society. These disparate groups had to a limited degree worked together in the defeat of the Clinch River Breeder Reactor, and this experience helped to make possible another cooperative effort.

The environmentalists' interest in curbing funding for multilateral lending institutions reflects a growing concern that such aid constitutes nothing more than an effort to export the U.S. Army Corps of Engineers philosophy to the Third World. Environmentalists have long noted the effectiveness of economic arguments in arguing against economically wasteful and environmentally disastrous public works projects. They have come to accept the premise that good economic policy generally promotes good environmental policy. Because environmental groups have limited resources and the strength of the environmental movement in the Third World is low, environmentalists have come to see curtailed public works spending in the Third World as essential to their objectives. Environmentalists organized

[11]As director of government affairs, the author led the Council's efforts in the IMF area.

the first systematic review of the problems in a recent hearing, "Environmental Impact of Multilateral Development Bank Funded Projects," held on June 28–29, 1983, before the House Banking Committee. Future IMF debates are likely to see increasing opposition from environmentalists.

The IMF situation has many similarities with the Clinch River experience. The IMF encourages a pattern of centralized, large-scale government spending in the Third World, in that the IMF lends to governments not individuals. Moreover the same pattern of major corporate support emerged in the IMF debate. Political systems tend to respond to power and often power correlates with special interests. So it is not surprising that the administration, the Chamber of Commerce, and the National Association of Manufacturers, among other special-interest groups, supported both the IMF and Clinch River. Special interests recognize the benefits of politically allocated resources and invest their political resources in protecting these privileges. Government is largely manned by groups who have long worked with these special interests and they act as allies whenever any effort is made to reduce their power. The success of the Taxpayer Coalition Against Clinch River suggests that these forces can be overcome, given enough time and energy.

Supporters of the IMF quota increase, however, included groups other than those business interests having a direct financial stake in the IMF. Agribusiness, for example, joined the financial community in supporting the measure. Proponents also numbered public-interest groups among their ranks. These included the League of Women Voters and the Consumers for World Trade, along with such academic groups as the Institute for International Economics. The support of the league is longstanding and stems largely from its belief that the IMF is a vital element in promoting international trade and development. This belief was repeated in a letter to U.S. senators from league president Dorothy S. Ridings (1983):

> The IMF plays a vital role in promoting worldwide financial stability and contributes to economic progress in the developing world. . . . The [IMF] funding would help support the development of country projects vital to increasing the living standards of millions of people.

The IMF also continues to enjoy the support of a number of free trade, humanitarian organizations. These groups are likely to oppose the IMF as they become more familiar with the findings of free-market analysts that contrast the rhetoric of the IMF with its reality. Nonetheless it is clear that a major educational task remains in this area.

Media Treatment of the IMF Issue

The most disastrous area for those opposing the IMF increase was that of media relations. The coalition found it extremely difficult to arrange for a full discussion of the intellectual and moral case against the quota increase. To most of the press, the IMF debate involved a group of enthusiastic but ignorant populists on the left and right opposing the reasoned views of all right-thinking people. For example, the *Washington Post* (1983a) editorialized that opposition to the IMF reflected "ignorance, misdirected zeal and isolationism. . . ." That viewpoint was repeated in editorials in almost every major newspaper in the nation. The substantive points raised by the IMF opponents received very little attention; rather the coverage given focused on the opposition coalition and the tactics employed.

The coalition's inability to obtain an adequate public debate on the pros and cons of the IMF was unfortunate. As most legislators had only a tenuous understanding of the issues involved, the overwhelming editorial support given to the IMF increase had a major impact. Legislators, like most people, know only what they read in the papers, and thus decided that the IMF increase must be good public policy.

Lobbying on the IMF Question

Initially the IMF question was not a familiar one to most of the groups involved in the coalition. Nor was the issue one on which large amounts of explanatory materials existed. The coalition was forced to develop educational materials and find ways of talking about the issue. Moreover coalition members had some difficulty in meeting directly with legislators, for in many cases the IMF question seemed far afield from the legislators' normal agenda.

Many of the liberal opponents also adopted a reformist position with respect to the issue. This made combined lobbying difficult, because few groups agreed on what if any steps would make the IMF increase acceptable. Some favored greater regulatory supervision over those banks involved in international lending, whereas others favored language requiring the U.S. representative to the IMF to promote human rights or environmental values. None of these provisions were well developed, and most would not attract the support of other members of the coalition. Efforts to develop a uniform position were unavailing, given the time pressures. The members of the coalition generally opposed the increase, but many of the groups were willing to sign off on an increase if certain conditions were met. The lack of strong agreement was inevitable in such a broad-based coalition in its initial stages; nonetheless it did complicate the lobbying task.

In contrast the supporters of the increase were well prepared to present an impressive case. After all they were defending a position that was favorably treated in the press, seemed consistent with many of the better values of this nation, represented conventional wisdom, and had the backing of many powerful groups. Also the administration used its not inconsiderable influence to obtain one-on-one meetings with almost all House and Senate legislators having any doubts about the measure. Secretary Regan, for example, was quoted in the *Financial Times* (1983) as saying, "I lobbied 400 out of 435 congressmen before that vote." If the secretary's account is accurate, he spent an enormous amount of his time on this issue, indicating the level of support accorded this measure by the administration.

In sum the coalition's effort was relatively successful. A number of important tasks were achieved that will provide an advanced base for future opposition work in this area. A number of public interest groups are conversant with the nuances of the IMF debate, the problems with presenting the issue are well understood, and an impressive base of intellectual material exists. The media are likely to reassess the issue given additional time, and there will be time.

VII. Conclusion

The IMF debate was the first major challenge to the conventional wisdom that government institutions have a primary role in managing the world economy. That premise has for some time now come under attack in such domestic economic policy areas as energy and transportation, and it is long overdue in the foreign-assistance area. The coalition forged during the last year is likely to oppose such other forms of foreign aid as the Export-Import Bank. Moreover the private sector itself seems to be rethinking its reliance on the IMF. The emergence of private-sector firms prepared to supply credit information on debtor nations is encouraging and suggests that the arguments developed in this paper are better understood than indicated in the public statements of the IMF proponents.

The IMF increase should have been defeated, but its victory was extremely narrow and no one believes a future increase will have easier going. The battle has already had some positive impact in tightening the resolve of those within the administration who oppose the government-knows-best philosophy in the foreign arena. The latest World Bank "replenishment" is likely to be funded at a level somewhat lower than desired by its proponents. The IMF fight has given an opportunity for market-oriented individuals in the administration to fight a more successful fight in other areas. For example, Beryl W. Sprinkel of the Treasury Department recently questioned (1983) why the United States should help nations that have done little to help themselves. He asked: "Do they [the nations receiving World Bank transfers] have an economic system that encourages savings, encourages investment, encourages work, that encourages adjustments, or do they have a rigid system?" Such statements suggest that the opposition to the IMF increase has already yielded some benefits. In sum the game seems to have been worth the candle—and there will be other rounds.

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"THE POLITICS OF IMF LENDING": A COMMENT

Robert Solomon

I shall discuss Mr. Smith's paper[1] under three headings: (1) the purposes and functions of the International Monetary Fund (IMF); (2) the nature of the international lending process; and (3) the performance of the major developing-country debtors. In the course of my comments I shall appraise the main proposition of the paper—that the IMF should be an international credit-rating agency but not a lender, and therefore it does not need financial resources in the form of increased quotas (or presumably any other form).

The Purposes and Functions of the IMF

Mr. Smith's paper characterizes the main purpose of the Fund as follows: "the IMF was to manage a world system of fixed exchange rates" (p. 212). The fact is that the Fund was created to prevent a repetition of what happened in the international monetary sphere during the 1930s, when countries used quantitative import restrictions, bilateral trade agreements, and competitive depreciation in efforts to achieve or increase trade surpluses as a way of overcoming deep depression. These policies came to be known as beggar-thy-neighbor practices. They were a negative sum game. All countries were made worse off by them.

Those who created the Fund had in mind several purposes. Perhaps the principal one was to promote the growth of unrestricted multilateral trade. To this end, the Articles of Agreement of the Fund call for currency convertibility and the avoidance of exchange restrictions so that the proceeds of a country's exports could be spent

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[1]"The Politics of IMF Lending," *Cato Journal* 4 (Spring/Summer 1984): 211–41.

anywhere in the world. The Articles did not call for "fixed" exchange rates, but they did state that exchange-rate parities were to be altered only if there were a fundamental disequilibrium and only with the permission of the Fund. The purpose here was to prevent competitive depreciations. Another purpose was to provide a pool of funds from which countries could borrow so that, if they were under balance-of-payments strain, they would not adopt measures "destructive of national or international prosperity," as in the 1930s.

The Fund thus had, at its inception, two major functions: to preside over a code of international economic and monetary conduct by its members and to be a source of temporary finance for countries that found themselves in balance-of-payments deficit either because of their own policy mistakes or because of external economic events over which they had no control. A third function has emerged in recent years. The Fund is becoming a forum for consultations about, and perhaps coordination of, macroeconomic policies among its members, particularly the larger industrial countries.

It should be noted that there is no substantive basis for the claim that IMF loans encourage centralized government spending. What the IMF lends is foreign exchange. The proceeds of IMF loans go to the central banks of the borrowing countries. The central banks are thus able to make foreign exchange available to importers, which could be primarily private firms and individuals or governmental entities, depending on the economic organization of the country. But there is nothing in the IMF lending process that pushes the borrowing country to more government involvement in the economy.

To say, as Mr. Smith and Milton Friedman do, that the original purpose of the Fund was eliminated when the world went to floating exchange rates is, in my view, simply wrong. It ignores a large body of economic literature about the determination of exchange rates and the phenomenon of "overshooting." The United States itself found it useful to borrow from the Fund in 1978 as part of its effort to stop the depreciation of the dollar.

More broadly, it is clear that, underlying the conception of the Fund, is the belief that not all problems are amenable to solution by market forces. Just as most nations, at the end of World War II, adopted measures that gave the central government—the fiscal and monetary authorities—responsibility to maintain high levels of employment in the belief that this would not happen automatically, in the international field the need for collective action was recognized by the establishment of the Fund. Such action need not be hostile to market forces. It simply supplements these forces.

The International Lending Process

Against this background, I now turn to Mr. Smith's proposal that the IMF confine its activities to rating the credit-worthiness of nations. He seems to believe that all nations have access to bank credit and that once the Fund gives its seal of approval to any of its member countries, banks would readily come forward to lend to them. The fact is that most member countries of the Fund are not in a position to borrow from banks. Three-fourths of total bank credit to all non-oil developing countries has gone to seven nations. The great majority of developing countries do not receive loans from banks even when they are operating under the Fund's seal of approval. These are the poorer countries that are dependent on the International Development Association (IDA) and bilateral aid for development finance. When they are under temporary balance-of-payments strain, because of a fall in their export prices or a harvest failure or a policy error, they have nowhere else to turn but the Fund. In the case of most member countries of the IMF, it is simply not true that private sector lenders provide more financing than the Fund does. When Mr. Smith formulated his proposal, he must have been thinking of countries like Brazil and Mexico, not Bangladesh or Somalia or Haiti or dozens like them.

Another objection to the proposal that the IMF should become only a credit appraiser is that the banks recently displayed less than warm enthusiasm about lending to countries that have received the IMF seal of approval. The term "involuntary lending" has been used to describe the process by which the IMF, with some help from central banks and governments, persuaded the banks to lend to Mexico and Brazil last year and again this year. This is a complex subject and we do not have to explore it fully to make the point that the lending by the IMF was a necessary condition for the bank lending that Mr. Smith would like to rely on completely. The IMF lending was necessary in two senses. The banks are unlikely to have agreed to lend unless the IMF was also putting in funds. Second, the amounts the banks were willing to lend would not have been sufficient and needed to be supplemented by the IMF.

On the basis of these considerations, one can conclude that the IMF should be even a larger lender than it has been in the past two or three years. A person of Mr. Smith's philosophy cannot be happy about involuntary lending. On the other hand, no one can deny that Brazil and Mexico, not to mention other countries, needed to borrow heavily. To a large extent, their balance-of-payments problems were not of their own making but were the result of the combination of recession and high interest rates in the industrial countries. The only alternative to involuntary lending would have been even larger loans from the IMF. That would have called for an even bigger increase in the IMF quotas, which Mr. Smith opposed.

Mr. Smith's response to this point would be, judging from his paper, that financing by the IMF makes the situation worse. He believes that external shocks and internal mismanagement create the need for painful adjustments which the IMF financing delays. Recession and high interest rates in the industrial countries are external shocks. It is simply poor economics to argue that developing countries subject to these shocks must reduce their living standards correspondingly instead of having the deflationary shock cushioned by temporary loans.

On the basis of Mr. Smith's arguments, one must conclude that he is opposed to unemployment compensation arrangements within countries. If mismanagement by corporate executives or by national policy makers leads to increased unemployment, the workers and their families should make do on their own, unless they can borrow from private sources. The lending function of the IMF is the international counterpart of governmental programs designed to protect families from temporary and reversible economic events that would require them to cut their living standards drastically. It is possible, of course, that Mr. Smith opposes such programs. That would make him consistent.

Performance of Major Borrowers

Mr. Smith is opposed to "providing the IMF with the wherewithal to bail out any nation and its bank creditors when poorly thought through investments go sour" (p. 231). He attacks Brazil in particular for a history of wasteful investment. I wonder how well Mr. Smith knows the record of economic performance in Brazil. The fact is that real GNP in Brazil increased at an average annual rate of more than 8 percent from 1970 to 1981. Wasteful investment is not likely to have generated such an impressive rate of growth. And Brazil is on its way to becoming an industrial country. About half of its exports are industrial goods. Moreover its export volume increased at an average rate of 8.7 percent per year from 1970 to 1981. Not all these exports could have been subsidizied. Brazil must have been using the inflow of capital productively. As a matter of fact, Brazil is now exporting commuter aircraft to the United States and other countries.

Thus I strongly disagree with Mr. Smith's appraisal of Brazil's economic record. The relevance of this to the subject at hand is that

Brazil's impressive growth and export performance came to an abrupt halt only when the industrial countries went into recession and when interest rates rose to astronomical levels. Brazil's export prices, measured in dollars, fell 20 percent from 1980 to 1982. The volume of its exports, after rising 8.7 percent per year for more than a decade, fell almost 9 percent in 1982. Meanwhile, the Eurodollar interest rate to which most of Brazil's bank loans are linked rose to almost 17 percent in 1981. Thus if there ever was a case that fits the original purposes of the IMF, it is Brazil in the past three years.

As to the analogy between the banks that have loaned to Mexico and Penn Square, an important difference is that the investments in Mexico have not failed. Mexico's petroleum exports have continued to increase. In April of 1983, the latest figure available to me, the volume of these exports was double what it was in 1980. No doubt, Mexico made policy mistakes. But it was also hit by the sharp rise in interest rates to which I have referred. In any event the Fund has done nothing to prevent the bankruptcy of individual enterprises in Mexico. If such failures occurred, the lending banks would have had losses, just as Penn Square did.

Concluding Comment

I conclude with the hope that Mr. Smith will direct his zealous energy to a worthier cause, such as the fight against protectionism, instead of working to weaken one of the most successful and effective international institutions. This world of growing interdependence needs a stronger, not a weaker, International Monetary Fund.