Citizen's Guide to

THE WORLD BANKING CRISIS

1983

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Howard Phillips
President

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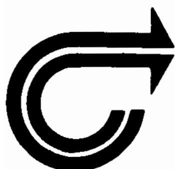

The Conservative Caucus
Research, Analysis & Education
Foundation
450 Maple Avenue East, Vienna, Virginia 22180

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THE WORLD DEBT CRISIS: A SIMPLIFIED INTRODUCTION

The world debt crisis of 1983, and the steps proposed to solve it — or shift the unpleasantness to someone else — are rooted in a sequence of events dating back to 1944, and involving institutions and practices far removed from the experience of the ordinary citizen. The nature of today's problem, however, can be understood by any intelligent citizen in possession of a few fundamental facts.

In 1944, as World War II drew to a close, the major free world nations came together in an historic financial conference at Bretton Woods, in New Hampshire's White Mountains. There they created two important institutions which today play major roles in the world economy — and in decisions that affect every worker, farmer, retiree, small business person, and community in the Western world.

The first of the Bretton Woods institutions was the International Bank for Reconstruction and Development, commonly known as the World Bank. The purpose of the World Bank is to make loans for development projects like highways, power plants, airports, and agricultural enterprises, which promise to generate sufficient revenue to repay the loans over a substantial period of time. Today, third world governments or government-owned corporations are common borrowers.

The other Bretton Woods institution — and the one most discussed in connection with the world debt crisis — is the International Monetary Fund. In 1944 the U.S. dollar was by far the world's strongest trade currency, and it was convertible into gold at the rate of $35 per troy ounce. The value of other currencies — the pound sterling, the yen, the Deutschmark, the franc, and so forth — were fixed by official exchange rates to the dollar, and thus to gold. The dollar thus came to be the world's reserve currency.

To understand why the IMF was needed, it is necessary to see what happens under this kind of regime when a nation pursues irresponsible economic policies. Suppose a nation — "Ruritania" — lives beyond its means. Its government engages in heavy deficit spending which starts an inflationary spiral. The Ruritanian dinar, which is supposed to be worth one fifth of a U.S. dollar (and thus worth one seventh of an ounce of gold), begins to drop in value. No one will exchange a dollar for five Ruritanian dinars any more. So long as Ruritania insists on the previous fixed exchange rate, Ruritanian importers cannot finance purchases from abroad in dollars. If allowed to do so, buyers will scramble to exchange dinars for Ruritania's gold stock. Ruritania's trade comes to a halt. Its gold and other reserve assets dwindle. Its economy may plunge into a deep recession.

At this point Ruritania's leaders have several choices. They can remedy the irresponsible economic policies that got them into this fix. They can devalue the dinar — establish a new and more realistic exchange rate of, say, eight to the dollar. And they could seek temporary balance of payments financing to keep their economy afloat while they take their medicine.

Now obviously if every country is wholly free to play games with the value of its currency, a round of "beggar they neighbor" actions could occur which would cripple world trade. And if there is no source of balance of payments financing to give the Ruritanian leadership a chance to put new economic policies into place to resolve their underlying problems, calamitous action becomes more likely.

Enter the IMF. The IMF was created to monitor exchange rate policies and currency devaluations and revaluations among its member countries (now numbering 146), to prevent irresponsible practices and financial throatcutting. And it was authorized to "make financial resources available to members, on a temporary basis and with adequate safeguards, to permit them to correct payments imbalances without resorting to measures destructive of national and international prosperity." In connection with this lending function, the IMF has come to supply a good bit of economic advice to borrowing countries. This is called "conditionality" — imposing conditions as the price of financial resources.

During approximately the Eisenhower and Kennedy years the IMF worked very well. This was an era of relatively stable prices and growing international cooperation in lowering trade barriers. But things began to go sour with U.S. involvement in an increasingly expensive war in Viet Nam, while at the same time the Johnson Administration vastly expanded domestic welfare spending.

The result was large (for that period) budget deficits and the beginnings of the inflation that devastated the American economy later in the 70s. Changes in the economic policies of our trading partners led to increasingly frequent exchange rate changes. Speculators grew in number, trying to make a kill by engineering massive short term capital movements in between exchange rate movements. As the dollar grew more cheap through inflation, foreigners presented more and more of them to get gold at $35 to the ounce — a bargain.

In 1968 President Johnson stopped honoring gold claims from all claimants except foreign governments or central banks. But by 1971 even foreign governments and central banks were beginning to find $35 gold irresistible. To prevent a final hemorrhage of America's gold stock, President Nixon on August 15, 1971 "closed the gold window" — refused to honor gold conversion claims. Eighteen months later the U.S. devalued the dollar by ten percent, and the era of fixed exchange rates tied to a reserve currency backed by gold came to an end.

The end of the gold standard theoretically made IMF's lending function obsolete. The idea of lending funds to enable troubled countries to buy time to avoid currency devaluation under a regime of fixed exchange rates, as existed prior to 1971, no longer had any meaning in an era of "floating" exchange rates — rates established by supply and demand in the daily marketplace, instead of through government fiat. But the IMF establishment was not content to abandon its most important lever of power, the loan lever. And so it came to pass that the IMF began to convert itself into a world central bank — a "lender of last resort" not to preserve fixed exchange rates, but to satisfy other objectives.

The story now departs from the IMF to examine the trends in the world economy since 1971. In 1973 came the first OPEC oil shock. An unprepared industrialized world was bled white by dramatically increased prices for OPEC crude. The OPEC countries naturally spent much of their increased oil earnings on goods and services in world trade. But some of them — especially the thinly populated Arab states — accumulated enormous hoards of dollars. Since the Arabs were largely prevented by cultural, religious, and political reasons from making direct investment in land, resources, and enterprises in the Western na-

tions, they sought out the major Western banks in which to deposit their billions. The bank gladly accepted the deposits.

But to a bank, a deposit is a liability. Banking requires relending the depositor's funds at a higher rate of interest, and making a profit from the spread. So the large Western banks — like Chase Manhattan, Bank of America, and Citicorp — went looking for qualified borrowers.

These banks could have scoured the countryside for home builders, small businesses and farms to finance. But lending such enormous quantities of money to thousands of little borrowers requires expensive loan administration and a wide network of branches, a limited option due to laws against interstate branch banking. So the banks discovered what they thought were better borrowers — foreign governments.

And at this point many third world and communist governments were looking for loans. In many cases their economies, riddled with the absurdities of central planning and nationalization, were proving to be losers. In many others, big bank loans proved to be a fertile opportunity for feathering numerous nests. In most the borrowed funds were used not for responsible investment that promised to generate an income stream, but simply to buy oil and food.

The big banks loved it. They could lend billions on one set of documents, at high interest rates, with lucrative front end fees, to governments which, the bankers assumed, simply could not repudiate their debts. Why the bankers naively believed this, in view of sovereign debt repudiations dating back to 1327 (when Edward III of England defaulted to two famous Italian banking houses), continues to be a mystery. Most analysts believed that the bankers made the loans because they expected a patron nation to make good for its client (like the USSR for Poland); or because they believed the IMF would inject new funds to stave off any problems; or some technique could be invented for the banks to unload their worthless loan paper on some suckers, such as U.S. taxpayers; or, if worse came to worst, the Federal Reserve could be persuaded to inflate the dollar, making bad debts repayable in cheap dollars. Bankers, as lenders, do not like inflation for this reason, but repayment in cheap dollars is far better than the ultimate horror, writing off loans as worthless.

And so the big banks got in deeper and deeper. As of the end of 1982 non-OPEC developing countries owed $520 billion. Of this, at least $182 billion was owed to banks, and of that, $108 billion was owed to U.S. banks. Over half of this ($57.2 billion) was owed to the nine largest international banks alone, and much of the rest was owed to smaller banks lured into foreign lending through syndicates assiduously promoted by the big banks.

The nine largest U.S. banks, as of the end of 1982, had a total capital (exclusive of loan loss reserves) of about $24 billion. They had lent $60.3 billion — 222% of their capital — to the forty major non-OPEC developing countries. They had lent over $30 billion to the three largest debtors alone — Mexico, Brazil, and Argentina. Loans were being "rescheduled" right and left, and in most instances the banks were forced to lend their debtors yet more money to help them pay the interest due on the original loans. This is desperation banking, and the banks were eagerly looking for a way out.

This was not, it must be noted, the first time that the major U.S. banks have looked for a way out involving the identification of somebody else to hold the bag. They lobbied for the Lockheed loan guarantee in 1970. They came back for more help when New York City threatened to go belly up in 1975, after a decade of increasingly irresponsible fiscal mismanagement. They did the same to rescue their debtor, Chrysler. They lobbied Congress into approving a new IMF "supplemental financing facility" in 1978 to channel more funds to dubious third world borrowers. They became staunch advocates of the Carter Administration's Panama Canal Treaty in 1978, to produce new toll revenues that would allow the government of Panama to service its enormous foreign loans.

The big banks — particularly Chase Manhattan — virtually took over the Carter Administration's foreign policy late in 1979 to force a freeze on Iranian assets, before the Khomeini government could figure out how to penalize the Chase for its long association with the deposed Shah. Fifty two Americans spent a year as hostages in Teheran as a result of that caper, until the banks, more than the government, negotiated a settlement in Algiers. And the same banks, in early 1982, over the anguished protests of Solidarity and the AFL-CIO, persuaded the Reagan administration to make good on $71 million in commodity loan guarantees without declaring the required default — which would have triggered defaults in all Western loans to the martial law regime of Poland. This is not an honorable record.

Almost as fast as it collected on a quota increase approved in 1980, the IMF establishment began to promote the idea of additional quota subscriptions from its member countries. Until August, 1982 the Reagan Administration was noticeably cool to another increase, at least before the next normal replenishment scheduled for 1985. But Mexico's sudden flirtation with bankruptcy turned the Reagan Administration around. On March 2, 1983 the President asked Congress to approve an additional IMF injection of $8.4 billion.

If approved and paid in, the IMF would use the additional $47 billion (the US share is just under 20%) to make more loans to LDCs on the verge of default. According to Treasury Secretary Regan, this investment is essential because it will buy time for an orderly transition from the present perilous situation to one in which the great bulk of the LDC loans are gradually repaid. The failure to provide these funds, he argues, would mean a constriction of trade. Widespread LDC defaults could wipe out the nation's largest banks. That could lead to a ruinous contraction of our own money supply as domestic loans are liquidated to replace defaulted foreign loans and consumed capital. Secretary Regan's case is stated at length in the first of the items published in this booklet.

There are, however, powerful arguments against the official case, as many of the following items show. Those arguments include the following:

1) This is yet another desperate makeshift scheme; the real problems — notably those of restoring a sound gold-based international monetary standard and redirecting world economic policies toward free markets, free trade, and noninflationary growth — are not being responsibly addressed.

2) This is a pure and simple rescue operation for the big banks which made irresponsible loans at large profits, and now want the taxpayers to pay the bills.

3) The IMF quota increase sucks capital away from American small businesses, farmers and homebuyers, and exports it for the benefit of far less worthy borrowers. The funds should be used for investment and growth here at home.

4) Forcing more debt on debt-ridden LDCs is not a cure; it merely worsens their situation and makes the ultimate resolution more painful.

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The most comprehensive and authoritative case for the IMF quota increase is the testimony of Treasury Secretary Regan before the Senate Appropriations Committee, Subcommittee on Foreign Operations, May 17, 1983. It is reprinted here almost in its entirety.

THE INCREASE IN IMF RESOURCES: PROTECTING THE FINANCIAL SYSTEM, SAFEGUARDING U.S. TRADE AND EMPLOYMENT

Donald T. Regan, Secretary of the Treasury

It is a pleasure to appear before you today to explain and support the Administration's proposals for legislation to increase the resources of the International Monetary Fund. After extensive consultations and negotiations among IMF members, agreement was completed in February on complementary measures to increase IMF resources: an increase in quotas, the IMF's basic source of financing; and an expansion of the IMF's General Arrangements to Borrow (GAB), for lending to the IMF on a contingency basis if needed to deal with threats to the international monetary system. These must now be confirmed by member governments involving Congressional authorization and appropriation in our case, in order to become effective.

President Reagan submitted the Administration's legislative proposals to the Congress early in March. As background to those proposals, I would like to outline the problems facing the international financial system, the importance to the United States of an orderly resolution of those problems, and the key role the IMF must play in solving them.

The International Financial Problem

Around the middle of last year, the serious financial problems confronting the international monetary system became front-page news — and correctly so, since management of these problems is critical to our economic interests. The debts of many key countries (including Argentina, Brazil, Mexico, and a growing list of others) became too large for them to continue to manage under present policies and world economic circumstances. In response, lenders began to retrench sharply, and the borrowers have since been finding it difficult if not impossible to scrape together the money to meet upcoming debt payments and to pay for essential imports. As a result, the international financial and economic system is experiencing strains that are without precedent in the postwar era and which threaten to derail world economic recovery.

There is a natural tendency under such circumstances for financial contraction and protectionism — reactions that were the very seeds of the depression of the 1930s. It was in response to those tendencies that the International Monetary Fund was created in the aftermath of World War II, largely at the initiative of the United States, to provide a cooperative mechanism and a financial backstop to prevent a recurrence of that slide into depression. If the IMF is to be able to continue in that role, it must have adequate resources.

The current problem did not arise overnight, but rather stems from the economic environment and policies pursued over the last two decades. Inflationary pressures began mounting during the 1960's, and were aggravated by the commodity boom of the early 1970's and the two oil shocks that followed. For most industrialized countries, the oil shocks led to a surge of imported inflation, worsening the already growing inflationary pressures; to large transfers of real income and wealth to oil exporting countries; and to deterioration of current account balances. For the oil-importing less developed countries — the LDCs — this same process was further compounded by their loss of export earnings when the commodity boom ended.

Rather than allowing their economies to adjust to the oil shocks, most governments tried to maintain real incomes through stimulative economic policies, and to protect jobs in uncompetitive industries through controls and subsidies. Inflationary policies did bring a short-run boost to real growth at times, but in the longer run they led to higher inflation, declining investment and productivity, and worsening prospects for real growth and employment.

Similarly, while these policies delayed economic adjustment somewhat, they could not put it off forever. In the meanwhile, the size of the adjustment needed was getting larger. Important regions remained dependent on industries whose competitive position was declining; inflation rates and budget deficits soared; and — most pertinent to today's financial problems — many oil importing countries experienced persistent, large current account deficits and unprecedented external borrowing requirements. Some oil-exporting countries also borrowed heavily abroad, in effect relying on increasing future oil revenues to finance ambitious development plans.

In the inflationary environment of the 1970's, it was fairly easy for most nations to borrow abroad, even in such large amounts, and their debts accumulated rapidly. Most of the increased foreign debt reflected borrowing from commercial banks in industrial countries. By mid-1982, the total foreign debt of non-OPEC developing countries was something over $500 billion — more than five times the level of 1973. Of that total, roughly $270 billion was owed to commercial banks in the industrial countries, and more than half of that was owed by only three Latin American countries — Argentina, Brazil, and Mexico. New net lending to non-OPEC LDCs by banks in the industrial countries grew at a rising pace — about $37 billion in 1979, $43 billion in 1980, and $47 billion in 1981 — with most of the increase continuing to go to Latin America.

That there has been inadequate adjustment and excessive borrowing has become painfully clear in the current economic environment — one of stagnating world trade, disinflation, declining commodity prices, and interest rates which are still high by historical standards. Over the past two years, there has been a strong shift to anti-inflationary policies in most industrial countries, and this shift has had a major impact on market attitudes. Market participants are beginning to recognize that our governments intend to keep inflation under control in the future and are adjusting their behavior accordingly.

In most important respects, the impact of this change has been positive. Falling inflation expectations have led to major declines in interest rates. There has been a significant drop in the cost of imported oil. On the financial side, there is a shift toward greater scrutiny of foreign lending which may be positive for the longer run, even though there are short-term strains. Lenders are re-evaluating loan portfolios established under quite different expectations about future inflation. Levels of debt that were once expected to decline in real terms because of continued inflation — and therefore to remain easy for borrowers to manage out of growing export revenues — are now seen to be high in real terms and not so manageable in a disinflationary world. As a result, banks have become more cautious in their lending — not just to LDCs but to domestic borrowers as well.

There is certainly nothing wrong with greater exercise of prudence and caution on the part of commercial banks — far from it. Since banks have to live with the consequences of their decisions, sound lending judgment is crucial. In addition, greater

scrutiny by lenders puts pressure on borrowers to improve their capacity to repay, and creates an additional incentive for borrowing countries to undertake needed adjustment measures.

But a serious short-run problem has arisen as a result of the size of the debt of several key countries, the turn in the world economic environment, inadequacy of adjustment policies, and the speed with which countries' access to external financing has been cut back. Last year, net new bank lending to non-OPEC LDCs dropped by roughly half, to something in the range of $20 to $25 billion for the year as a whole and came to a virtual standstill for a time at mid-year. This forced LDCs to try to cut back their trade and current account deficits sharply to match the reduced amount of available external financing.

They only fast way for these countries to reduce their deficits significantly in the face of an abrupt cutback in financing is to cut imports drastically, either by sharply depressing their economies to reduce demand or by restricting imports directly. Both of these are damaging to the borrowing countries, politically and socially disruptive, and painful to industrial economies like the United States — because almost all of the reduction in LDC imports must come at the direct expense of exports from industrial countries.

As the situation developed, there has been a danger that lenders might move so far in the directions of caution that they compound the severe adjustment and liquidity problems already faced by major borrowers, and even push other countries which are now in reasonably decent shape into serious financing problems as well.

The question is one of the speed and degree of adjustment. While the developing countries must adjust their economies to reduce the pace of external borrowing and maintain their capacity to service debt, there *is* a limit, in both economic and political terms, to the speed with which major adjustments can be made. Effective and orderly adjustment takes time, and attempts to push it too rapidly can be destabilizing.

Importance to the United States of an Orderly Resolution

It is right for American citizens to ask why they and their government need be concerned about the international debt problem. Why should we worry if some foreign borrowers get cut off from bank loans? And why should we worry if banks lose money? Nobody forced them to lend, and they should live with the consequences of their own decisions like any other business.

If all the U.S. government had in mind was throwing money at the borrowers and their lenders, it would be difficult to justify using U.S. funds on any efforts to resolve the debt crisis, especially at a time of domestic spending adjustment.

But of course, there *is* more to the problem, and to the solution. First, a further abrupt and large-scale contraction of LDC imports would do major damage to the U.S. economy. Second, if the situation were handled badly, the difficulties facing LDC borrowers might come to appear so hopeless that they would be tempted to take desperate steps to try to escape. The present situation is manageable. But a downward spiral of world trade and billions of dollars in simultaneous loan losses would pose a fundamental threat to the international economic system, and to the American economy as well.

In order to appreciate fully the potential impact on the U.S. economy of rapid cutbacks in LDC imports, it is useful to look at how important international trade has become to us. Trade was the fastest growing part of the world economy in the last decade — but the volume of U.S. exports grew even faster in the last part of the 1970's, more than twice as fast as the volume of total world exports. By 1980, nearly 20 percent of total U.S. production of goods was being exported, up from 9 percent in 1970, although the proportion has fallen slightly since then.

Among the most dynamic export sectors for this country are agriculture, services, high technology, crude materials and fuels. American agriculture is heavily export-oriented: one in three acres of U.S. agricultural land, and 40 percent of agricultural production, go to exports. This is one sector in which we run a consistent trade surplus, a surplus that grew from $1.6 billion in 1970 to over $24 billion in 1980.

Services trade — for example, shipping, tourism, earnings on foreign direct investment and lending — is another big U.S. growth area. The U.S. surplus on services trade grew from $3 billion in 1970 to $34 billion in 1980, and has widened further since. When both goods and services are combined, it is estimated that one-third of U.S. corporate profits derive from international activities.

High technology manufactured goods are a leading edge of the American economy, and not surprisingly net exports of these goods have grown in importance. The surplus in trade in these products rose from $7.6 billion if 1970 to $30 billion in 1980. And even in a sector we do not always think of as dynamic — crude materials and non-petroleum fuels like coal — net exports rose six-fold, from $2.4 billion to $14.6 billion over the same period.

Vigorous expansion of our export sectors has become critical to employment in the United States. The absolute importance of exports is large enough — they accounted directly for 5 million jobs in 1982, including one out of every eight jobs in manufacturing industry. But export-related jobs have been getting even *more* important at the margin. A survey in the late 1970s indicated that four out of every five *new* jobs in U.S. manufacturing was coming from foreign trade; on average, it is estimated that every $1 billion increase in our exports results in 24,000 new jobs. Later I will detail how Mexico's debt problems have caused a $10 billion annual-rate drop in our exports to Mexico between the end of 1981 and the end of 1982. By the rule of thumb I just mentioned, that alone — if sustained — would mean the loss of a quarter of a million American jobs.

These figures serve to illustrate the overall importance of exports to the U.S. economy. The story can be taken one step further, to relate it more closely to the present financial situation. Our trading relations with the non-OPEC LDCs have expanded even more rapidly than our overall trade. Our exports to the LDCs, which accounted for about 25 percent of total U.S. exports in 1970, rose to about 29 percent by 1980.

What these figures mean is that the export sector of our economy — a leader in creating new jobs — is tremendously vulnerable to any sharp cutbacks in imports by the non-OPEC LDCs. Yet that is exactly the response to which debt and liquidity problems have been driving them. This is a matter of concern not just to the banking system, but to American workers, farmers, manufacturers and investors as well.

Even on the banking side, there are indirect impacts of concern to all Americans. A squeeze on earnings and capital positions from losses on foreign loans not only would impair banks' ability to finance world trade, but also could ultimately mushroom into a significant reduction in their ability to lend to domestic customers and an increase in the cost of that lending.

Beyond our obvious interest in maintaining world trade and trade finance, there is another less-recognized U.S. financial interest. The U.S. government faces a potential exposure through Federal lending programs administered by Eximbank and the Commodity Credit Corporation. This exposure — built in support of U.S. export expansion — amounted to $35 billion at the end of 1982, including $24 billion of direct credits (mostly from Eximbank) and $11 billion of guarantees and insurance.

Argentina, Brazil and Mexico are high on the list of borrowers. Should loans extended or guaranteed under these programs sour, the U.S. Treasury — meaning the U.S. taxpayer — would be left with the loss.

All industrial economies, including the American economy, will inevitably bear some of the costs of the balance of payments adjustments LDCs must make and are already making. This adjustment would be much deeper, for both the borrowing countries and for lending countries like the United States, if banks were to pull back *entirely* from new lending this year. In 1983, for example, a flat standstill would require borrowers to make yet another $20 to $25 billion cut in their trade and current account deficits, which would be considerably harder to manage if it came right on the heels of similar cuts they have already made. Further adjustments are needed — but again the question is one of the size and speed of adjustments. If these countries were somehow to make adjustments of that size for a second consecutive year, the United States and other industrial countries would then have to suffer large export losses once again. At the early stages of U.S. and world economic recovery we are likely to be in this year, a drop in export production of this size could abort the gradual rebuilding of consumer and investor confidence we need for a sustained recovery.

In fact, many borrowers have already taken very difficult adjustment measures to get this far. If they were forced to contemplate a second year of further massive cutbacks in available financing, they could be driven to consider other measures to reduce the burden of their debts. Here potentially lies a still greater threat to the financial system.

When interest payments are more than 90 days late, not only are bank profits reduced by the lost interest income, but they may also have to begin setting aside precautionary reserves to cover potential loan losses. If the situation persisted long enough, the capital of some banks might be reduced.

Banks are required to maintain an adequate ratio between their underlying capital and their assets — which consist mainly of loans. For some, shrinkage of their capital base would force them to cut back on their assets — meaning their outstanding loans — or at least on the growth of their assets — meaning their new lending. Banks would thus be forced to make fewer loans to all borrowers, domestic and foreign, and they would also be unable to make as many investments in securities such as municipal bonds. Reduced access to bank financing would thus force a cutback in the expenditures which private corporations and local governments can make — and it would also put upward pressure on interest rates.

The usual perception of international lending is that it involves only a few large banks in the big cities, concentrated in half a dozen states. The facts are quite different. We have reliable information from bank regulatory agencies and Treasury reports identifying nearly 400 banks in 35 states and Puerto Rico that have foreign lending exposures of over $10 million — and in all likelihood there are hundreds more banks with exposures below that threshold but still big enough to make a significant dent in their capital and their ability to make new loans here at home. Banks in most states are involved, and the more abruptly new lending to troubled borrowing countries is cut back, the more likely it is that the fallout from their problems will feed back on the U.S. financial system and weaken our economy.

Resolving the International Financial Problem

Debt and liquidity problems did not come into being overnight, and a lasting solution will also take some time to put into place. We have been working on a broad-based strategy involving all the key players — LDC governments, governments in the industrialized countries, commercial banks, and the International Monetary Fund. This strategy, which was first outlined in my testimony before the full Banking Committee last December, has five main parts:

First, and in the long run most important, must be effective adjustment in borrowing countries. In other words, they must take steps to get their economies back on a stable course, and to make sure that imports do not grow faster than their ability to pay for them. Each of these countries is in a different situation, and each faces its own unique constraints. But in general, orderly and effective adjustment will not come overnight. The adjustment will have to come more slowly, and must involve expansion of productive investment and exports. In many cases it will entail multi-year efforts, usually involving measures to address some combination of the following problems: rigid exchange rates; subsidies and protectionism; distorted prices; inefficient state enterprises; uncontrolled government expenditures and large fiscal deficits; excessive and inflationary money growth; and interest rate controls which discourage private savings and distort investment patterns. The need for such corrective policies is recognized, and being acted on, by major borrowers — with the support and assistance of the IMF.

The second element in our overall strategy is the continued availability of official balance of payments financing, on a scale sufficient to help see troubled borrowers through the adjustment period. The key institution for this purpose is the International Monetary Fund. The IMF not only provides temporary balance of payments financing, but also ensures that use of its funds is tied tightly to implementation of needed policy measures by borrowers. It is this aspect — IMF conditionality — that makes the role of the IMF in resolving the current debt situation and the adequacy of its resources so important.

IMF resources are derived mainly from members' quota subscriptions, supplemented at times by borrowing from official sources. Assessing the adequacy of these resources over any extended period is extremely difficult and subject to wide margins of error. The potential needs for temporary balance of payments financing depend on a number of variables, including members' current and prospective balance of payments positions, the availability of other sources of financing, the strength of the conditionality associated with the use of IMF resources, and members' willingness and ability to implement the conditions of IMF programs. At the same time, the amount of IMF resources that is effectively available to meet its members' needs at any point in time depends not only on the size of quotas and borrowing arrangements, but also on the currency composition of those resources in relation to balance of payments patterns, and on the amount of members' liquid claims on the IMF which might be drawn. In view of all these variables, assessments of the IMF's "liquidity" — its ability to meet members' requests for drawings — can change very quickly.

Still, as difficult as it is to judge the adequacy of IMF resources in precise terms, most factors point in the same direction at present. The resources now effectively available to the IMF have fallen to very low levels in absolute terms, in relation to broad economic aggregates such as world trade, and in relation to actual and potential use of the IMF.

At present, the IMF has about SDR 23 billion available for lending. However, SDR 16 billion of that total has already been committed under existing IMF programs, leaving only about SDR 7 billion available for new commitments. Given the scope of today's financing problems, requests for IMF programs by many more countries must be anticipated over the next year, and it is likely that the IMF's existing resources will have been fully committed by the end of this year. Thus, within six or seven months the IMF will have exhausted its ability to commit resources to new adjustment programs. I will return to our specific proposals in this area shortly.

The IMF cannot be our only buffer in financial emergencies.

It takes time for borrowers to design and negotiate lending programs with the IMF and to develop financing arrangements with other creditors. As we have seen in recent cases, the problems of troubled borrowers can sometimes crystallize too quickly for that process to reach its conclusion — in fact, the real liquidity crunch came in the Mexican and Brazilian cases before such negotiations even started.

Thus, the third element in our strategy is the willingness of governments and central banks in lending countries to act quickly if necessary to respond to debt emergencies. Recent experience has demonstrated the need to be willing to consider providing immediate and substantial short-term financing — but only on a selective basis, where system-wide dangers are present — to tide countries through their negotiations with the IMF and discussions with other creditors. We are undertaking this where necessary, on a case-by-case basis, through *ad hoc* arrangements among finance ministries and central banks, often in cooperation with the Bank for International Settlements. But it must be emphasized that they lending packages are short-term in nature, designed to last for only a year at most and normally much less, and cannot substitute for IMF resources which are designed to help countries through a multi-year adjustment process.

In fact, IMF resources themselves have only a transitional and supporting role. The overall amount of Fund resources, which substantial, is limited and not in any event adequate to finance all the needs of its members. While we feel that a sizable increase in IMF resources is essential, this increase is not a substitute for lending by commercial banks. Private banks have been the largest single source of international financing in the past to both industrial and developing countries, and this will have to be the case in the future as well — including during the crucial period of adjustment.

Thus, the fourth essential element in resolving debt problems is continued commercial bank lending to countries that are pursuing sound adjustment programs. In the last months of 1982 some banks, both in United States and abroad, sought to limit or reduce outstanding loans to troubled borrowers. But an orderly resolution of the present situation requires not only a willingness by banks to "roll over" or restructure existing debts, but also to *increase* their net lending to developing countries, including the most troubled borrowers, to support effective, non-disruptive adjustment.

The increase in net new commercial bank lending that has been arranged for just three countries — Brazil, Argentina, and Mexico — amounts to nearly $11 billion. For Brazil, the banks have agreed to provide new net lending of $4.4 billion, which would raise total commercial bank claims on Brazil to an estimated total of $65 billion. For Argentina, net new lending of $1.5 billion would raise claims to around $25 billion. For Mexico, net new lending of $5 billion will raise bank claims to something over $65 billion. Without such continued lending in support of orderly and constructive economic adjustment, the programs that have been formulated with the IMF could not succeed — and the lenders have a strong self-interest in helping to assure success. It should be noted, however, that new bank lending will be at a slower rate than that which has characterized the last few years — more in line with the increase in 1982 than what we saw in 1980 or 1981.

The final part of our strategy is to restore sustainable economic growth and to preserve and strengthen the free trading system. The world economy is poised for a sustained recovery: inflation rates in most major countries have receded; nominal interest rates have fallen sharply; inventory rundowns are largely complete.

Solid, observable U.S. recovery is one critical ingredient for world economic expansion. We believe the U.S. recovery is now underway, as evidenced by the recent drop in unemployment and the 3.1 percent increase (preliminary) in U.S. GNP during the first quarter of this year. Establishing credible growth in other industrial economies is also important, and we believe the base for recovery has been laid abroad as well.

However, both we and others must exercise caution as this turning point. Governments must not give in to political pressures to stimulate their economies too quickly through excessive monetary or fiscal expansion. A major shift at this stage could place renewed upward pressure on inflation and interest rates.

In addition, rising protectionist pressures, both in the United States and elsewhere, pose a real threat to global recovery and to the resolution of the debt problem. When one country takes protectionist measures hoping to capture more than its fair share of world trade, other countries will retaliate. The result is that world trade shrinks, and rather than any one country gaining additional jobs, everybody loses. More importantly for current debt problems, we must remember that export expansion by countries facing problems is crucial to their balance of payments adjustment efforts. Protectionism cuts off the major channel of such expansion. That adjustment is essential to restoring problem country debtors to sustainable balance of payments positions and avoiding further liquidity crises — and as we have seen, it is therefore essential to the economic and financial health of the United States.

The only solution is a stronger effort to resist protectionism. As the world's largest trading nation, the United States carries a major responsibility to lead the world away from a possible trade war. The clearest and strongest signal for other countries would be for the United States to renounce protectionist pressures at home and to preserve its essentially free trade policies. That signal would be followed, and would reinforce, continued U.S. efforts to encourage others to open their markets, and would in turn be reinforced by IMF program requirements for less restrictive trade policies by borrowers.

The Role and Resources of the IMF

I have stressed the role of the International Monetary Fund in dealing with the current financial situation, and now I would like to expand on that point. The IMF is the central official international monetary institution, established to promote a cooperative and stable monetary framework for the world economy. As such, it performs many functions beyond the one we are most concerned with today — that of providing temporary balance of payments financing in support of adjustment. These include monitoring the appropriateness of its members' foreign exchange arrangements and policies, examining their economic policies, reviewing the adequacy of international liquidity, and providing mechanisms through which its member governments cooperate to improve the functioning of the international monetary system.

In that context, it becomes clearer that IMF financing is provided only as part of its ongoing systemic responsibilities. Its loans to members are made on a temporary basis in order to safeguard the functioning of the world financial system — in order to provide borrowers with an extra margin of time and money which they can use to bring their external positions back into reasonable balance in an orderly manner, without being forced into abrupt and more restrictive measures to limit imports, The conditionality attached to IMF lending is designed to assure that orderly adjustment takes place, that the borrower is restored to a position which will enable it to repay the IMF over the medium term. In addition, a borrower's agreement with the IMF on an economic program is usually viewed by financial market participants as an international "seal of approval" of the borrower's policies, and serves as a catalyst for additional private

and official financing.

The money which the IMF has available to meet its members' temporary balance of payments financing needs comes from two sources: quota subscriptions and IMF borrowing from its members. The first source, quotas, represents the Fund's main resource base and presently totals some SDR 61 billion, or about $67 billion at current exchange rates. The IMF periodically reviews the adequacy of quotas in relation to the growth of international transactions, the size of likely payments imbalances and financing needs, and world economic prospects generally.

At the outset of the current quota discussions in 1981, many IMF member countries favored a doubling or tripling of quotas, arguing both that large payments imbalances were likely to continue and that the IMF should play a larger intermediary role in financing them. While agreeing that quotas should be adequate to meet prospective needs for temporary financing, the United States felt that effective stabilization and adjustment measures should lead to a moderation of payments imbalances, and that a massive quota increase was not warranted. Nor did we feel that an extremely large quota increase would be the most efficient way to equip the IMF to deal with unpredictable and potentially major financing problems that could threaten the stability of the system as a whole, and for which the IMF's regular resources were inadequate.

Accordingly, the United States proposed a dual approach to strengthening IMF resources:

— First, a quota increase which, while smaller than many others had wanted, could be expected to position the IMF to meet members' needs for temporary financing in normal circumstances.

— Second, establishment of a contingency borrowing arrangement that would be available to the IMF on a stand-by basis for use in situations threatening the stability of the system as a whole.

This approach has been adopted by the IMF membership, in agreements reached by the major countries in the Group of Ten in mid-January, and by all members at the IMF's Interim Committee meeting early last month.

The agreed increase in IMF quotas is 47 percent, an increase from SDR 61 billion to SDR 90 billion (in current dollar terms, and increase from $66 billion to $98 billion). The proposed increase in the U.S. quota is SDR 5.3 billion ($5.8 billion at current exchange rates) representing 18 percent of the total increase.

The Group of Ten, working with the IMF's Executive Board, has agreed to an expansion of the IMF's General Arrangements to Borrow from the equivalent of about SDR 6.5 billion at present to a new total of SDR 17 billion, and to changes in the GAB to permit its use, under certain circumstances, to finance drawings on the IMF by any member country. Under this agreement, the U.S. commitment to the GAB would rise from $2 billion to SDR 4.25 billion, equivalent to an increase of roughly $2.6 billion at current exchange rates.

We believe this expansion and revision of the GAB offers several important attractions and, as a supplement to the IMF's quotas, greatly strengthens the IMF's role as a backstop to the system:

— First, since GAB credit lines are primarily with countries that have relatively strong reserve and balance of payments positions, they can be expected to provide more effectively usable resources than a quota increase of comparable size. Consequently, expansion of the GAB is a more effective and efficient means of strengthening the IMF's ability to deal with extraordinary financial difficulties than a comparable increase in quotas.

— Second, since the GAB will not be drawn upon in normal circumstances, this source of financing will be conserved for emergency situations. By demonstrating that the IMF is positioned to deal with severe systemic threats, an expanded GAB can provide the confidence to private markets that is needed to ensure that capital continues to flow, thus reducing the risk that the problems of one country will affect others.

— And third, creditors under this arrangement will have to concur in decisions on its activation, ensuring that it will be used only in cases of systemic need and in support of effective adjustment efforts by borrowing countries.

The proposed increase in U.S. commitments to the IMF totals SDR 7.7 billion — SDR 5.3 billion for the increase in the U.S. quota and SDR 2.4 billion for the increase in the U.S. commitment under the GAB. At current exchange rates, the dollar equivalents are $8.4 billion in total, $5.8 billion for the quota increase and $2.6 billion for the GAB increase.

We believe these steps to strengthen the IMF if enacted, will safeguard the IMF's ability to respond effectively to current financial problems. Given the financing needs that are foreseen, IMF members have agreed that it is important that the increases be implemented by the end of this year. Without such a timely and adequate increase in IMF resources, the ability of the monetary system to weather debt and liquidity problems will be impaired, at substantial direct and indirect cost to the United States.

Concerns about the Increase in IMF Resources

The general outline of our proposals has been known to members of Congress for some time. Many have expressed reservations or questions about this proposal, and I would like to discuss some of the main concerns now.

• Is the IMF "Foreign Aid"?

Many perceive money appropriated for IMF use to be just another form of foreign aid, and question why we should be providing U.S. funds to foreign governments. Let me assure you that the IMF is *not* a development institution. It does not finance dams, agricultural cooperatives, or infrastructure projects. The IMF *is* a *monetary* institution. Only one of its functions is providing balance of payments financing to its members in order to promote orderly functioning of the monetary system, and only then on a temporary basis, on medium-term maturities, after obtaining agreement to the fulfillment of policy conditions. Financing is not provided in one lump sum to borrowing countries, but is made available in parts only as they implement agreed policies. We have been working very hard with the IMF to ensure that both the effectiveness of IMF policy conditions, and the temporary nature of its financing, are safeguarded. In this way, the Fund's financing facilities will continue to have a revolving nature and to promote adjustment.

IMF conditionality has been controversial over the years, with strong opinions on both sides. Some observers have worried that conditionality is so weak and ineffective that conditional lending is virtually a giveaway. Others believe that conditionality is too tight — that it imposes unnecessary hardship on borrowers, and stifles economic growth and development.

Such generalizations reflect a misunderstanding of IMF conditionality. When providing temporary resources to a country faced with external financing problems, the IMF seeks to assure itself that the country is pursuing policies that will enable it to live within its means — that is, within its ability to obtain foreign financial resources. It is this that determines the degree of adjustment that is necessary. It is often the case that appropriate economic policies will strengthen a country's borrowing capacity, and result in both higher import growth and higher export growth. I would cite the example of Mexico as an immediate case in point.

Mexico is our third largest trading partner, after Canada and Japan. And, as recently as 1981, it was a partner with whom we had an export boom and a substantial trade surplus, exporting goods to meet the demands of its rapidly growing population and developing economy. This situation changed dramatically in 1982, as Mexico began experiencing severe debt and liquidity problems. By late 1982, Mexico no longer had access to financing sufficient to maintain either its imports or its domestic economic activity. As a result, U.S. exports to Mexico dropped by a staggering 60 percent between the fourth quarter of 1981 and the fourth quarter of 1982. Were our exports to Mexico to stay at their depressed end-1982 levels, this would represent a $10 billion drop in exports to our third largest market in the world. Because the financing crunch got worse as the year wore on, totals for the full year 1982 don't tell the story quite so dramatically — but even they are bad enough. Our $4 billion trade surplus with Mexico in 1981 was transformed into a trade deficit of nearly $4 billion in 1982, due mainly to an annual-average drop in U.S. exports of one-third. This $8 billion deterioration was our worst swing in trade performance with any country in the world, and it was due almost entirely to the financing problem.

We believe that now this situation will start to turn around, and we can begin to resume more normal exports to Mexico. If this happens, it will be due in large part to the fact that, late in December, an IMF program for Mexico went into effect; and that program is providing the basis not only for IMF financing, but for other official financing and for a resumption of commercial bank lending as well. Mexico must make difficult policy adjustments if it is to restore creditworthiness. The Mexican authorities realize this and are embarked on a courageous program. But the existence of IMF financing and the other financing associated with it will permit Mexico to resume something more like a normal level of economic activity and imports while the adjustment takes place in an orderly manner. Without the IMF program, all we could look forward to would be ever-deepening depression in Mexico and still further declines in our exports to that country.

There is another aspect of the distinction between IMF financing and foreign aid which we should be very clear on, since it goes to the heart of U.S. relations with the Fund. All IMF members provide financing to the IMF under their quota subscriptions, and all — industrial and developing alike — have the right to draw on the IMF. Quota subscriptions form a kind of revolving fund, to which all members contribute and from which all are potential borrowers.

As an illustration, in practice our quota subscription has been drawn upon many times — and repaid — over the years for lending to other IMF members. We in turn have drawn on the IMF on 24 occasions — most recently in November 1978 — and our total cumulative drawings, amounting to the equivalent of $6.5 billion, are the second largest of any member (the United Kingdom has been the largest user of IMF funds).

• Do IMF Programs Promote Protectionism and Hurt U.S. Exports?

There is a perception that IMF programs are designed to cut imports and growth in borrowing countries, and that the IMF encourages protectionist measures as a means to reduce imports. More generally, it is argued by some that, far from helping to maintain world trade and U.S. exports, IMF programs actually hurt exports by the United States and other industrial countries by reducing overall import demand in borrowing countries.

Both of these arguments are just plain wrong. The purpose of an IMF program *is* to restore a borrower's external position to a sustainable basis — but that doesn't take place solely, or in the long run even primarily, by restraining imports. In fact, it is frequently the case that a country's imports under an IMF program are *higher* than in the period before that program went into effect — and generally *far* higher that would have been possible in the absence of the program.

The logic of this process should be clear. By the time many countries approach the Fund, they have permitted economic and financial conditions to deteriorate to such an extent that their access to normal sources of credit is severely restricted, if not cut off altogether. Without the policy reforms instituted under an IMF program, the temporary financing the IMF makes available, and the additional private and official financing its program catalyzes, imports and economic activity would be curtailed sharply. Adjustment would be abrupt and disorderly. We saw this happen in Mexico last year, before its IMF program was put in place.

In contrast, *with* an IMF program a borrowing country receives additional financing which enables it to maintain higher levels of growth and imports, even when it is putting strong adjustment measures in place. In the longer run as well, a successful program makes a higher level of imports and a higher economic growth rate possible. For as I have said earlier, orderly adjustment entails not just the cooling of overheated demand, but also a wide range of measures to increase a borrowing country's economic efficiency and productive capacity, and hence its ability to grow and to pay for imports.

In fact, this conclusion is borne out vividly by the performance envisioned under 26 new IMF conditional adjustment programs — 23 recently approved, and three proposed. In the great majority of these, real economic growth is expected to improve in the first year of the program as compared with the preceding two years; growth is expected to decline in the first year in only 7 of the 26. The same is true for imports under these Fund programs: imports are expected to be higher in the first program year than in the two preceding years in 19 out of 26 cases.

The programs for Mexico, Argentina, and Brazil all fit this category. In Mexico the real economic growth rate fell from 8.1 percent in 1981 to zero in 1982; and imports fell from $23 billion in 1981 to less than $15 billion in 1982. Since the vast majority of Mexico's imports come from the United States, Mexico's ability to import in the future matters quite a lot to us. In the first year of the new IMF program, Mexico's imports are projected to rise by 2 percent, and by another 14 percent next year.

In Argentina real GNP declined for two years preceding the IMF program, and imports dropped from $9.4 billion in 1981 to $5.5 billion in 1982. Under the IMF program, Argentina's imports are projected to rise by 18 percent over two years and real growth is expected to resume. In Brazil, real GDP fell 3.5 percent in 1981 and stagnated in 1982, while imports dropped from $22 billion in 1981 to $19.4 billion in 1982. Brazil's imports are expected to decline significantly further this year, but to grow over the course of their three-year IMF program as a whole; indeed, excluding oil, Brazil's imports in the third program year are projected to be some 35 percent higher than last year. Clearly, not all IMF programs can lead to increased imports in the short run, especially where imports were unsustainably high beforehand. But IMF programs *do* permit a higher short-run import level than would be possible without a program, and are always designed to lead to longer-term increases.

The suggestion that the IMF encourages trade protectionism as a means of balance of payments adjustment does not stand up under scrutiny either. The entire history and philosophy of the organization run in the opposite direction — toward a free and open trading system — as do its practices. It aims at liberalizing trade policies as far as possible in order to minimize economic distortions and stimulate competition. For this purpose, the performance criteria in IMF programs always include an

injunction against the imposition or intensification of import or payments restrictions for balance of payments reasons. If actions are taken which violate these prohibitions, the borrower is prevented from using additional IMF credit until the issue can be resolved satisfactorily to the Fund.

In fact, these performance criteria designed to avoid *increased* protectionism are only half the story. The other half is that the IMF also actively seeks the reduction and elimination of *existing* import restrictions and export subsidies by providing for the adoption of more efficient, market-oriented measures during program periods. Among the 38 Fund programs approved between January 1, 1982, and February 28, 1983, 30 included some positive reform or liberalization of a country's exchange or trade system.

• Why Not Spend the Money at Home?

Another major concern with the proposals to increase IMF resources is that, in this period of budgetary stringency, many beleive we would be better advised to spend the money at home. There is also some feeling that if we were to get the U.S. economy moving forward again, the international financial problem would take care of itself. I think I've already been through part of the response to these concerns when I described the large growing impact which foreign trade now has on American growth and employment. We will do what is necessary domestically to strengthen our economy. But we will leave a major threat to domestic recovery unaddressed if we do not act to resolve the international financial situation. The direct impact alone of international developments on our economy is so large that, were the international situation not to improve, there would at a minimum be a tremendous drag on our economic recovery.

It is true that an improving U.S. economy is going to help other nations, both through our lower interest rates and through an expanding U.S. market for their exports — providing of course that we don't cut them off from that market. But they also have an immediate, short-run financing crunch to get through, and if we don't handle that right there are substantial downside risks for the United States.

• Budgetary Treatment

This might also be the right context in which to discuss how U.S. participation in the increase in IMF resources would affect the Federal budget and the Treasury's borrowing requirements. Under budget and accounting procedures adopted in connection with the last IMF quota increase, in consultation with the Congress, both the increase in the U.S. quota and the increase in U.S. commitments under the GAB will require Congressional authorization and appropriation. However, because the United States receives a liquid, interest-earning reserve claim on the IMF in connection with our actual transfers of cash to the IMF, such transfers do not result in net budget outlays or an increase in the Federal budget deficit.

Actual cash transactions with the IMF, under our quota subscription or U.S. credit lines, do affect Treasury borrowing requirements as they occur. The amount of such transactions in any given year depends on a variety of factors, including the rate at which IMF resources are used; the degree to which the dollar in particular is involved in both current IMF drawings and repayments of past drawings; and whether the United States itself draws on the IMF.

An analysis appended to this statement at Annex C presents data on the impact of U.S. transactions with the IMF between U.S. fiscal year 1970 and the first quarter of fiscal 1983 on Treasury borrowing requirements. Although there have been both increases and decreases in Treasury borrowing requirements from year to year, on average there have been increases amounting to about $½ billion annually over the entire period, for a cumulative total of about $7 billion. The rate has picked up in the last two years of heavy IMF activity, as would be expected; but the total is still relatively small — the $½ billion annual impact is only a small part of the $61 billion annual average increase in Treasury borrowing over the same period, and the roughly $7 billion cumulative impact compares with an outstanding Federal debt of $1.1 trillion at the end of fiscal 1982. These figures also serve to demonstrate the revolving nature of the IMF.

• Is the IMF a Bank "Bail-Out"?

I also know there is a widespread concern that an increase in IMF resources will amount to a bank bail-out at the expense of the American taxpayer. Many would contend that the whole debt and liquidity problem is the fault of the banks — that they've dug themselves and the rest of us into this hole through greed and incompetence, and now we intend to have the IMF take the consequences off their hands. This line of argument is dangerously misleading, and I would like to set the record straight.

First, the steps that are being taken to deal with the financial problem, including the increase in IMF resources, require continued involvement by the banks. Far from allowing them to cut and run, orderly adjustment requires *increased* bank lending to troubled LDCs that are prepared to adopt serious economic programs. That is exactly what is happening.

And it is not a departure from past experience. I have had Treasury staff review IMF program experience in the 20 countries which received the largest net IMF disbursements in the last few years, to see whether banks had been "bailed out" in the past. Looking at the period from 1977 to mid-1982, they found that for the countries which rely most heavily on private bank financing, IMF programs have been followed up by new bank lending much greater than the amount disbursed by the Fund itself. This also holds true for the 20 countries as a group: net IMF disbursements to this group during the period were $11.5 billion, while net bank lending totalled $49.7 billion, resulting in a ratio of 4.3 to 1 during this period.

It is clear that IMF resources are not being used to enable banks to pull out of lending to troubled countries. But a question is frequently raised about how IMF financing *is* used. The correct, if rather broad, answer is that it is used for general balance of payments support.

One must remember that many of the countries now undertaking IMF programs have previously reached a stage where financing was no longer available to them to allow them to conduct normal international transactions. IMF financing is provided to member governments to enable them to resume such transactions while adjustment is taking place. There are a wide variety of specific international transactions which governments themselves engage in, including merchandise imports, purchases of services from abroad, and various capital transactions. Some, but only a part, of these transactions are related to interest on, and repayments of, past borrowing from commercial banks. In addition, in most developing countries the foreign exchange market is so small and rudimentary that it is managed by the government or central bank. As a result, demands for foreign exchange resources of the type provided by IMF financing must also be met by LDC governments in facilitating a large variety of transactions related to imports, purchases of services, and capital transactions by private citizens — a function which in the United States is performed by private foreign exchange markets. Because money is fungible it is neither possible nor meaningful to ascribe the financing provided by the IMF to any particular subset pf a borrowing country's balance of payments transactions.

Another point I would like to make is that the whole debt and liquidity problem cannot fairly be said to be the fault of the commercial banks. In fact, the banking system as a whole

performed admirably over the last decade, in a period when there were widespread fears that the international monetary system would fall apart for *lack* of financing in the aftermath of the oil shocks. The banks managed almost the entire job of "recycling" the OPEC surplus and getting oil importers through that difficult period. Some of the innovations and decisions that banks made to them and to others, may seem doubtful in retrospect, given the way the world economic environment changed. But I think we can agree that governments have had a great deal more to do with shaping that environment than banks.

These remarks are not intended to absolve the banks of any blame. We have been examining what banks — and banks regulators — should do to improve on their practices and procedures. The primary role of bank regulation is and must continue to be ensuring the safety and soundness of the banking system, but this must evolve in concert with the dynamics of domestic and international financial developments.

In considering possible changes to regulatory practices, several points should be borne in mind which militate against drastic changes. One is that "safety and soundness" is not necessarily best achieved through rigid limits or abrupt adjustments. Customers which are temporarily illiquid but no insolvent may merit additional funds, and the system as a whole could suffer if banks were unduly discouraged from extending such new credits. I believe that there is at present little danger of a resurgence of bank lending to LDCs at imprudent rates. There is a relatively greater danger that some banks will seek to avoid participating in the moderate increase in new net lending that forms one pillar of the five-point strategy I have previously set forth.

A second consideration is that the government should not relieve the banks of responsibility for lending decisions. It is bank managements, which have direct experience with the borrowers and a responsibility to their shareholders and depositors, that are in the best position to make lending decision.

A third consideration is that U.S. banks do not operate in isolation from their peers — and competitors — in other countries. It is impractical and unnecessary to achieve an identity of regulatory practices internationally, but some consistency among regulatory regimes is desirable.

Debate over possible changes to our regulatory framework has focused on areas such as the adequacy of the existing system for evaluating country risk and identifying concentrations, greater disclosure and more frequent reporting, the possibility of special reserves for problem loans, the accounting for fee income, and the adequacy of capital of banks. This debate is healthy, and I commend the Congress for encouraging it and for advancing a number of proposals. It has been greatly assisted as well by the submission of a Joint Memorandum on April 7 from the three bank regulatory agencies, and by their subsequent preparation, in response to a Congressional request, of draft legislation which would provide a legal mandate to implement the program set forth in the Joint Memorandum. These proposals have been included in legislation reported by the Banking Committees of both Houses.

This debate deals with a sensitive and central part of our economy. The decisions taken will have important implications both for resolving the present situation and for the evolution of the banking system in the future. I am hopeful that its outcome will be one of constructive and evolutionary changes that are consisten with the principles I have discussed.

Possible Alternatives

Finally, there have been various proposals for basic alternatives to the IMF quota increase or, indeed, to the general strategy that has been adopted to deal with the debt situation. These generally involve use of IMF gold as a substitute or partial substitute for the quota increase, some kind of generalized system of debt relief, or a large scale write-off of debt. I do not believe these offer realistic or desirable alternatives to the approach being followed or to the proposed increase in IMF resources.

Use of IMF Gold. Several proposals have been advanced for "mobilization" of some or all of the IMF's gold holdings, either as an alternative to the agreed increase in quotas and expansion of the GAB, or in conjunction with those measures. These proposals vary, but generally envisage:

— sales of gold to the private market, with the proceeds used to finance regular IMF operations;

— sales of gold to members at the old official price of SDR 35 per ounce (now about $38) in proportion to their quotas in August 1975 — under the so-called gold "restitution" provisions;

— loans of gold to members;

— use of the gold as collateral for IMF borrowing in private markets.

Any decision to sell IMF gold requires an 85 percent majority vote; the IMF has no authority to lend gold to its members.

From the point of view of the IMF, it would have to sell its entire gold stock of 103 million ounces to generate the roughly $42 billion total agreed for the quota and GAB increase. This is not realistic. Such sales over a period of a few years would probably depress the price in a major way, perhaps dramatically. An effort to stretch the sales out over an extended period, in order to minimize the price effects, would leave the IMF without the resources to finance prospective commitments in the more immediate future.

Similarly, proposals to "restitute" IMF gold, through sales to members at the old official price, would simply deplete the Fund's resources. Even if all the gold were sold in this way, the IMF would obtain the equivalent of only about $4 billion. Moreover, the countries experiencing the greatest financial problems would receive little benefit — far less than they could borrow from the IMF, under appropriate conditionality, with the proposed increase in IMF resources. Restitution would essentially represent a windfall for the wealthier IMF members, not a contribution to resolution of the debt situation.

At present, all IMF assets, including the IMF's gold, serve as backing for creditors' claims on the Fund. Such claims currently total about $35 billion, including U.S. claims of $9.4 billion. These claims are liquid, and the existence of the Fund's gold reserve assures that these claims can be met if they are encashed. It is extremely unlikely that current IMF creditors would be willing to have this security eliminated as a result of IMF gold sales or subordinated to IMF pledges of gold to other lenders.

For these reasons, any international discussions of the use of IMF gold would be contentious and protracted, and it is extremely unlikely that the 85 percent majority vote that would be needed could be obtained for a decision to sell all or a substantial part of the IMF's gold. The creditors do not want their security impaired; and neither the creditors nor the borrowers want to see the IMF's resources depleted.

From the United States' own point of view, the economic and financial effects of gold sales could far outweigh any costs associated with Treasury borrowings in connection with the proposed quota increase. First, the U.S. is the single largest IMF creditor today, with claims on the IMF totaling over $9.4 billion. Sales of the gold and use of the proceeds for IMF lending would remove this security for our claims.

Second, major IMF gold sales could lead to a dramatic drop in gold prices and reduce the potential value of our own gold

holdings, about $115 billion at current market prices. A price drop of only $32 an ounce — a small amount in the volatile gold market — would totally offset the $8.4 billion proposed for increase in U.S. participation in the IMF. A very substantial price drop, which would seem more likely in the face of large-scale IMF gold sales, would have serious adverse consequences for domestic gold producers and precipitate large losses on the gold stocks of the United States and other countries.

Third, the sale of IMF gold would not eliminate the financial market effects that concern some in connection with the quota increase and Treasury borrowing. The gold would be acquired by investors, in part financed through sales of U.S. corporate or Treasury securities. This would put pressures on interest rates and financial markets similar to, and possible greater than, those arising from any U.S. borrowing in connection with the quota increase.

From a broader perspective, the IMF is central to the agreed strategy for dealing with current problems in a way supportive of U. S. economic and foreign policy interests. After more than two years of negotiation, international agreement has been reached on measures to insure that the IMF has adequate resources to fulfill its responsibilities. An effort by the United States to alter this agreement and, in effect, to deplete the IMF's assets instead, would be strongly and appropriately rebuffed by other countries, with devastating consequences for international confidence in U.S. leadership.

Generalized Rescheduling of Debts. Proposals for generalized debt rescheduling fail to recognize the very substantial restructuring of debt that is already taking place or to distinguish among the very different situations of borrowing countries. Of the twenty largest LDC borrowers, accounting for 85 percent of total LDC debt to banks, some eight countries — accounting for nearly 60 percent of the total — have major restructurings in place or in progress. Many other countries do not appear to require rescheduling at this time and want to meet their obligations in a timely manner.

Generalized systems of debt relief are not needed or appropriate. Economic adjustment in borrowing countries is essential to resolving the debt problem and avoiding a recurrence; but these proposals would relieve many borrowers of essential pressure to adjust. Under some variants, they could create major disincentives for lenders to provide needed credit in the future; under others, there would be high costs for governments and taxpayers. Reschedulings and restructurings are taking place under the current strategy, but in a selective manner tailored to individual circumstances, so as to minimize disincentives to needed adjustment and private financing and to avoid undue cost to the taxpayer.

Debt Write-Offs. The assumption underlying proposals for large-scale write-offs of debt is that there is no hope of restoring orderly debt servicing and creditworthiness in many or most LDC borrowers. I do not agree with the basic assumption. The major borrowers — many admittedly over-extended today, with their export markets impaired by recession — resemble in important ways the developing U.S. economy of the 1800s. They require large amounts of capital to develop and grow. With proper policies and a reasonably stable world environment, their economies, their capacity to earn foreign exchange and their ability to service debt will all expand. Most of all should, with effort and discipline, again become creditworthy.

Mandatory large-scale write-offs would almost certainly cut off any future flow of new funds to LDCs and could induce banks to try to reduce their current exposure — making it virtually impossible for borrowers to adjust in an orderly and constructive way and putting enormous pressure on governments to pick up the financing burden. And major write-offs, by forcing the banks to take heavy losses which would wipe out their capital resources in the process, would cause the banking system to curtain domestic lending as well, tightening credit markets, raising interest rates and threatening our recovery.

Conclusion

The IMF plays a crucial role in the solution to current debt and liquidity problems, and in providing the environment for world recovery. It is absolutely essential that the proposed increase in IMF resources become effective by the end of this year, to enable the IMF to meet these responsibilities. Prompt U.S. approval is important not only because the financing is needed, but also because it would be a sign of confidence to other governments and to the public, and would help lay to rest concerns about the risks to global recovery posed by the international debt problem.

But most importantly, timely approval of these proposals is essential to our own economic interests — to the prospects for American businesses and American jobs.

REP. KEMP IN 1980: IMF OBSOLETE?

"The IMF was established to oversee the adjustment of international payments under the Bretton Woods gold exchange standard. Unfortunately this proved an impossible task, since the nature of a gold exchange standard is to block the automatic mechanism for adjusting international payments."

"When one or more currencies are privileged as reserve currencies — that is, are used as reserve assets by central banks — two pyramids of credit may be erected on the same gold reserve. A balance of payments deficit in the reserve currency country can duplicate itself; under the Bretton Woods system, dollars sent abroad were counted as reserves by foreign central banks, which simultaneously reinvested them back in the United States."

"This caused monetary expansion abroad and prevented any correction of the overexpansion of American credit which caused the payments deficit in the first place. The dollar became overvalued, and the system broke down under the weight of outstanding claims against American gold."

"When the gold exchange standard was replaced by the nonsystem of 'floating' exchange rates without gold convertibility, the main role of the IMF should presumably have ceased. After all, when American monetary authorities closed the gold window, they argued that the floating rates would make balance of payments adjustments unnecessary; instead, overabundant currencies would simply be allowed to depreciate. Needless to say, the regime of the past 9 years compares dismally with the Bretton Woods system, flawed as it was."

"Yet the IMF found a new function: 'recycling' international oil payments, especially for the Third World countries. Why this could not be handled exclusively by commercial banks is a mystery, unless the role of the IMF is to guarantee the imprudent overextension of risky credit by those banks."

"I cast my vote against the proposed IMF quota increase to protest the role of the United States in encouraging a dangerous overexpansion of debt which threatens the collapse of the world's financial system."

Rep. Jack Kemp (R-N.Y.)
September 17, 1980
Congressional Record, p. H9036.

IMF Loans: 'Bailing the Banks in Deeper'

'If Congress goes along with the quota increase [to the International Monetary Fund]. . . we have to give up the use of $8.4 billion of our resources. It is a transfer of our resources from our purposes to other countries' purposes on a permanent basis, and as such is equivalent to a higher tax on American incomes.'

Prof. Roberts, former assistant secretary of the treasury for economic policy in the Reagan Administration, is William E. Simons Professor of Political Economy at the Center for Strategic and International Studies at Georgetown University.

Q. Mr. Roberts, Federal Reserve Chairman Paul Volcker recently told the Congress that the threat of default by foreign governments on their loans to our banks poses "a threat to the recovery, the jobs, and the prosperity of our own country, a threat essentially without parallel in the postwar period." What is your opinion of the situation?

A. I believe that Mr. Volcker's rhetoric is excessive and that the atmosphere of crisis has prevented prudent and careful thinking about the situation. As a result the Congress is about to go along with a "solution" that will: (*1*) impose substantial costs on the U.S. economy that are being ignored; (*2*) worsen the international debt problem; (*3*) enfeeble U.S. diplomacy; and (*4*) transform the International Monetary Fund from an agency that provides temporary liquidity in the event of balance-of-payments problems into an aid-giving agency.

Q. What are the costs to the U.S. economy of participating in the eighth quota increase for the IMF?

A. There are several costs. One is that the Treasury has to finance the $8.4 billion that we are due to turn over to the IMF by borrowing in the credit markets.

In other words, the IMF quota increase is the same as a larger federal deficit. It offsets dollar for dollar any reduction in the budget deficit achieved by cutting defense spending, reducing Social Security benefits, and raising taxes. The total impact on our credit markets is greater than the $8.4-billion figure, because the IMF bailout packages require additional foreign lending by U.S. banks, thus reducing their ability to purchase U.S. government and corporate bonds at home.

According to Secretary of the Treasury Donald Regan's testimony before Congress, from 1977 to mid-1982 our private banks lent $4.30 abroad for every dollar in IMF loans. If that ratio continues to hold, our participation in the IMF-led bailout will drain $44.5 billion from our capital market ($8.4 billion + 4.3 × $8.4 billion).

In testimony before the Joint Economic Committee Mr. Volcker warned that there is not enough credit to go around and that unless Treasury borrowing is reduced, higher U.S. interest rates will work against the economic recovery at home.

Clearly, in Mr. Volcker's mind, the cost to the U.S. of a larger IMF quota is either higher interest rates and a weaker recovery or higher taxes or reduced defense and social spending. These costs are being ignored by the same U.S. policymakers who are responding to the federal deficit by trying to force President Reagan to abandon his supply-side tax policy and to cut his defense program.

There is a great deal of talk about how the International Monetary Fund forces troubled borrowers to retrench in order to straighten out their economies. However, if Congress goes along with the quota increase, we have to retrench too. We have to give up the use of $8.4 billion of our resources. Either the private capital markets or the Treasury or the taxpayers or the military or Social Security recipients — somebody has to do without the $8.4 billion because it is a real resource transfer. There is no way to disguise that fact. It is a transfer of $8.4 billion of our resources from our purposes to other countries' purposes on a permanent basis, and as such is equivalent to a higher tax on American incomes.

Q. Why does the IMF bailout of the foreign loans worsen the international debt problem?

A. The problem is that the Third World and Eastern European governments that are the troubled foreign borrowers already have more debt than they can service, and some of our large banks have more exposure in loans to these countries than the risk justifies. The IMF bailout loads up the debtor countries with more debt and forces more exposure on our banks.

In defending the Administration against the charge that it is using taxpayer money to bail out big bankers, government spokesmen like Secretary of State George Shultz have described the policy as one of bailing the banks in deeper.

Consider, for example, the Brazilian bailout. The $5.5-billion IMF loan to Brazil is conditional upon the private banks that are Brazil's creditors rolling over $4 billion in existing loans, making $4.4 billion in new loans, providing $10 billion in new trade credits and maintaining billions of dollars on deposit with Brazilian financial institutions. It is, in other words, piling debt on debt, so the risk of ultimate default worsens.

This brings us back to the cost to the U.S. consumer. The more our government and our banks get involved in propping up old loans with new ones, the greater the stake they acquire in the resurgence of world inflation. Rapidly rising oil and commodity prices would provide Third World countries with rising revenues to service a depreciating debt. It would be a shame if the one benefit — lower inflation—of the recession that the Federal Reserve has put the American people through was sacrificed to an inflationary bailout of a mountain of foreign debt.

Q. But what about the present crisis? Do you agree that there is one, and how would you address it?

A. I believe that the approach that is being taken to deal with the international debt problem is a greater danger than the "crisis" itself, if that is what it is. I would call it a problem that is in danger of being turned into a crisis by the solution that is being adopted.

I agree with George Champion, former chairman of Chase Manhattan Bank, that the best approach to the current problem is not to pile debt upon debt, but to allow the banks to build up larger tax-deductible loan loss reserves against their questionable foreign loans and require the banks to write down the value of the loans to what they can reasonably expect to collect. My solu-

tion would be to reduce the foreign exposure of our banks and to reduce the debt burden on the debtor countries.

Q. You said that by participating in the IMF bailout we run the risk of enfeebling our diplomacy. Would you explain what you mean? Many people believe that we need to go along with an enlarged IMF quota in order to help important countries like Mexico and Brazil in our back yard.

A. It does not help countries to load them up with more debt when they can't pay off what they already have. Loans are different from grants. If we want to give aid, we should do so bilaterally. When you give aid through a multilateral middleman, you lose control over whom the aid goes to and end up subsidizing Socialist and Communist governments. Also, when aid passes through a middleman, the donor country cannot extract a *quid pro quo*. The ultimate result is to divorce foreign aid from our foreign policy interests.

I agree with former Treasury Secretary Bill Simon that bilateral aid lets us control the decision whom to give to and when to give more, whereas the multilateral approach subjects our diplomacy to endless demands by the bloc of aid-receiving countries. Indeed, in a multilateral setting like the IMF, Third World countries can put pressure on our European allies to pressure us to enlarge the IMF's resources.

Q. Is that what you mean by the International Monetary Fund being turned into an aid-giving agency?

A. Yes, and there is an even greater threat to the integrity of the IMF. There is a danger that the pressure for wealth transfers from the West to the Third World will turn the IMF and other international financial organizations into agencies through which the West makes international transfer payments.

The IMF is supposed to make short-term loans to provide liquidity to tide over countries with temporary balance-of-payments problems, but as the international debt mounts up, the IMF is in danger of having to permanently underwrite deficits in the Third World's balance of payments. In other words, the IMF could become a *de facto* international IRS through which the Third World taxes us.

Q. But what if the alternative to turning the IMF into an aid-giving agency or even a tax man is the collapse of our banking system as a result of foreign governments defaulting on their loans? Which is worse?

A. The alternative to an IMF-led bailout is not default, but a partial write-down of the loans. Bank profits would be down temporarily as well as would management bonuses, and a few banking reputations would be bruised. But everyone would survive it and come out strengthened. Even in the event of default, it would not bring down our banking system unless the Federal Reserve was derelict. The Federal Reserve would provide reserves to the banking system and prevent a default from causing a contraction.

Q. But wouldn't this be inflationary?

A. No. The Federal Reserve would provide new reserves to offset the contraction of reserves caused by default. It would be a wash. The danger of inflation comes from getting everyone's prestige involved in the success of a bailout that piles debt on debt until it has to be inflated away. We are heading for trouble when we lend money to pay interest.

Q. What about the argument that by lending more abroad we will experience a rise in demand for our exports, thereby helping to reduce our unemployment rate?

A. Our exports would go up, but not dollar for dollar, because some of the money will be spent in other countries.

For example, say we lend $10 abroad instead of spending it at home and that $6 comes back and $4 is spent in other countries. The result is less spending on our goods and a rise in unemployment. Also, U.S. exports have high value-added but they are relatively low in labor intensity, so the result of lending abroad is to direct demand toward capital-intensive goods. The IMF-led bailouts cannot be described as a domestic jobs program.

Q. What about the conditions that the IMF imposes on troubled borrowers? Does the IMF make them reduce the size of the public sector and adopt free market principles?

A. The International Monetary Fund usually requires countries to take actions to reduce their imports and increase their exports in order to build up their foreign exchange holdings. In other words, the IMF requires troubled borrowers to reduce domestic consumption. Most often this means a tax increase, so the result of IMF conditionality is to cut back the private sector.

Rep. Jack Kemp has led the fight to convince the IMF that the higher taxes hurt incentives in the private sector, thereby further weakening the economy of the troubled country.

The IMF conditions were designed to pull a single country around. But today there are a large number of troubled countries. It is not possible for them all to increase exports and reduce imports at the same time. If no one is importing, who can export? In the current situation it means that the West is expected to import more and export less—which is another reason the IMF quota increase cannot be seen as a jobs program.

Q. How much control do we have over the IMF?

A. We have just under 20 per cent of the vote — enough to veto any changes to the IMF charter, but not enough to run the show. Based on our contribution to the IMF we should have about 40 per cent of the vote. However, the way the IMF is set up, countries can pay 75 per cent of their quota in their own currencies. Since the currencies of most countries are not convertible, that is, they are not acceptable as means of payment in international settlements, many of the IMF's members are not paying in anything real when they subscribe to a quota increase.

In other words, they are allowed to buy their share of the vote with play money. Most of the IMF's resources come from the U.S. and its allies. That is why a majority of the IMF's members favor a quota increase.

If there really is a crisis requiring a bailout, we should do it by setting up a temporary revolving fund. Then when the crisis is over the donor countries could withdraw their funds for their own use.

What is happening is that in the name of a temporary liquidity crisis we are being pushed into making a permanent transfer of our resources to the IMF.

Q. If you were still in the Treasury, what would you advise the President to do?

A. He should tell the Treasury and the Federal Reserve to find out what percentage of the loans have to be written down in order to make the remainder good. If it is a reasonable amount, and I believe it would be, it would let the crisis be solved rather than prolonged, worsened and perhaps turned into a lever for extracting international transfer payments from the U.S. and its allies to the rest of the world.

It wasn't that long ago that the U.S stood astride the world like a colossus. Our financial and diplomatic power was respected, and countries sought to be in our good graces. We even managed to conduct our diplomacy through our own institutions. But today, after subordinating our interests to international organizations, we stand before the world as Uncle Sap who antes up for foreigners while the President's tax cuts and defense buildup fall under the budgetary knife.

The world has serious problems that require U.S. leadership, but the U.S. cannot lead as long as it acquiesces to demands. We must strongly resist the notion that foreign debtors have our banks over a barrel or they will take advantage of the situation to extract ever more American resources through the International Monetary Fund. ■

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Cut Off the International Loan Lushes

By William E. Simon

Don't be fooled by all the political talk about Washington's concern with deficits. The government is $200 billion short of the ability to pay its bills this year. But that's not stopping politicians from borrowing $8.4 billion more so that the International Monetary Fund can lend more to foreigners who cannot pay their bills. We are witnessing the tragic spectacle of the deficit-ridden rescuing the bankrupt with an outpouring of more American red ink—and the taxpayer is left holding the bag.

Little thought is being given to the $8.4 billion off-budget appropriation for the IMF, because it is mistakenly seen as necessary to avoid a banking crisis. Some policymakers fear that without increased lending by the IMF, heavily indebted foreign governments might default, with serious consequences for U.S. banks that are overexposed in lending abroad.

But when fear comes in, reason departs, and piling debt upon debt cannot ultimately succeed. It not only delays the day of reckoning but exacts a high price: By extending credit to countries beyond their ability to repay, the final bankruptcy is worse; and by trying to bail out the irredeemable, we risk turning important institutions like the IMF into welfare agencies.

Should Only Be Temporary Aid

Historically, the IMF's function has been to provide short-term liquidity to help countries over temporary balance-of-payments problems. Longer-term projects or structural loans are, under the 1944 Bretton Woods agreement, the preserve of the World Bank. However, by pressuring for wealth transfers from "North" to "South," the Third World is attempting to turn both institutions into agencies through which the industrial democracies make international transfer payments.

Now, in the guise of avoiding default, we are about to take another step toward turning the IMF into an aid agency. The deeper the IMF gets involved in propping up old loans with new ones, the more likely the IMF will eventually assume the debt itself or permanently underwrite country deficits. In fact, so-called banking lifeboat schemes, under which some international institution would buy banks' loans to developing countries and then greatly extend their maturities, are popping up this year faster than spring crocuses. To protect the integrity of the international institutions, we must face the indebtedness problem squarely.

George Champion, former chairman of Chase Manhattan Bank, has proposed a sensible alternative to piling debt upon debt. The banks should write down the face value of their nonconforming loans and set aside larger reserves against their foreign loans. Indeed, the regulatory authorities charged with protecting the soundness of the banking system should require compulsory loan-loss reserves tied to those foreign loans that have not been repaid on time.

Congress is less likely to accept the pain of cutting spending when the gain from doing so is offset by the process of floating debt to fund the IMF.

There is no point to a bailout that increases world debt when the problem is too much indebtedness already. Countries are in trouble because they cannot service their current obligations. The strain on them is not eased by a bailout that loads them up with more.

The same holds for the private banks. The IMF-led bailout packages require banks that are already overexposed to get in deeper by lending more. For example, the $5.5 billion IMF loan to Brazil requires Brazil's commercial bank creditors to roll over $4 billion in existing debt, to make $4.4 billion in new medium-term loans, to provide $10 billion in new trade credits and to keep $7.5 billion on deposit with Brazilian financial institutions. Government officials seem to think that this policy is sound because it bails the banks in rather than out.

The deeper the IMF, the banks, the State Department, the Treasury, the Federal Reserve, Congress and the White House get involved in building a mountain of debt, the greater the stake they all acquire in the resurgence of world inflation. Rapidly rising commodity and oil prices would provide rising revenues with which to service a depreciating debt, and the American consumer would be the big loser.

It is bad enough when the U.S. Treasury repays its own obligations by issuing new ones, but to do this for the likes of Tanzania, Romania and oil-rich Mexico indicates that we have taken leave of our senses.

The politicians have a good line to hide the increased borrowing that Uncle Sam uses to pay his own bills—"we owe it all to ourselves." But they have an even better one to hide the debt Uncle Sap issues to finance an IMF quota increase in order to bail out the world. That debt, they say, is not debt at all, but an "asset swap."

When the Treasury gives the IMF 25% of our quota increase in hard cash and the remainder in a line of credit that is drawn on U.S. financial markets, the IMF certainly acquires real liquid assets. What it "swaps" with us is much less definite. We acquire a "claim" on the IMF denominated in Special Drawing Rights (SDRs), but it isn't a claim that we can cash in and spend. Indeed, if it were a real asset swap, instead of an accounting sleight of hand that disguises an international transfer payment, what would be the point of the quota increase?

When we agree to add to the IMF till, we transfer our resources to a supranational organization that we do not control, to be disbursed by an international bureaucracy. The multilateral approach has the advantage of dragging others into the aid process, and the U.S. isn't left alone holding the bag. But the disadvantages are great. It is hard to hold multilateral middlemen accountable, and we get in the habit of subsidizing every socialist government in the Third World.

A bilateral approach to aid-giving lets us avoid undercutting our own interests with our own money. Instead, the aid is directed to where it can best advance U.S. interests. Bilateral aid also lets us control the decision when to give more, whereas the multilateral approach subjects our diplomacy to endless demands by the bloc of aid-receiving countries.

An IMF quota increase is equivalent to a larger federal deficit because the Treasury has to finance it by borrowing in the credit markets. This borrowing offsets dollar for dollar any reductions in federal borrowing achieved by gaining control over our own budget. Proposals for authorizing the IMF to circumvent Congress and borrow directly in private markets would have the same effect. Congress is less likely to accept the pain of cutting spending when the gain from doing so is offset by the process of floating debt to fund the IMF.

Another Welfare Program

Since the end of World War II governments have attempted to "solve" problems and to buy prosperity through the leverage of debt finance. But if debt solved problems, the Third World and Eastern Europe—and the U.S. itself—would be riding the waves of prosperity. The problems aren't without their irony. For example, Brazil, which is currently undergoing a bailout, is itself a creditor to insolvent Poland. The current efforts to wash out insolvency with more red ink will multiply such absurdities of indiscriminate lending.

Proponents of the bailout claim that it is in our interest, because providing foreigners with more money will enable them to buy more of our goods, thus spurring our economy. This is like arguing that a shopkeeper can increase his sales by giving away money in the streets in the hope that some of it will be spent in his shop. Trade must be based on competition, not subsidies, or it becomes another welfare program.

As usual, leadership is scarce. Sen. Gordon Humphrey, Reps. Jerry Lewis and Jack Kemp, and former Assistant Treasury Secretary Paul Craig Roberts have begun to ask questions. Let's hope they keep on asking questions and that others join them. The U.S. taxpayer cannot afford the bills run up by our own spendthrift politicians. He shouldn't be expected to cover the debts of foreign governments too.

Mr. Simon is a former U.S. secretary of the Treasury.

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FEBRUARY 21, 1983

The bankers created this mess. Now they're demanding that we pay for it.

THE BIG BANK BAILOUT

BY WILLIAM J. QUIRK

HELPING THE RUSSIANS build missiles aimed at us is a pretty terrible thing for an American to do. You might even say it's treason. Helping the Arabs roll the price of oil from $2.50 a barrel (1972) to $34 a barrel (1982)—the results of which included deep recession, millions of unemployed, and untold misery—isn't exactly patriotic either. Why, then, over the past ten years, have we given away about $800 billion to help the Soviet and oil blocs?

To be sure, these billions were not called gifts, and they were not given with the consent or even the knowledge of the people. They were called loans and they were given by international bankers. The bankers gave the loans because they had figured out a way to profit from brokering away the West's wealth. They did so under the cover of two theories, "détente" and "recycling," the expensive side effects of which were never made clear to the American people.

DRAWING BY VINT LAWRENCE FOR THE NEW REPUBLIC

"Recycling" gave the impression that somehow the money was going to come back to us, but beyond that it was a little vague. "Détente" was to be, in Henry Kissinger's words, an instrument for "moderating Soviet conduct." The Soviet leaders saw it as a way to stabilize Communist Party rule in Eastern Europe and the Soviet Union. In the late 1960s, after fifty years of Communist power, the Soviet economy was coming up empty. Détente looked like a way to improve the economy without political risk to the Communist Party. The Russians thought they could hothouse Western technology and make it work within the existing system. They would be like Peter the Great, who, in the early eighteenth century, introduced Western industrial techniques into Russia. The trouble was, the modern Russians didn't have any money. Lenin is supposed to have said that the capitalists would sell him the rope with which he would hang them. Brezhnev decided he should get the rope on easy credit. The West, in essence, should agree to finance and stabilize the existing system of totalitarianism.

President Nixon was agreeable, but he didn't have any money either, and he couldn't very well ask Congress to appropriate taxpayer funds to aid Russia. It seemed equally unthinkable, at first, that a commercial bank could lend to a sovereign government. Governments are supposed to lend to other governments, since such loans are inherently political. The borrowing country will repay if, and only if, it is in its national interest at the time. David Rockefeller, however, then chairman of Chase Manhattan Bank, thought it could be arranged. With the banks providing the money, the Comecon "debt" snowballed from $7.9 billion in 1973 to over $80 billion in 1981. To collect on your "debt," if the Russians didn't feel like repaying, all you had to do was foreclose on the Kremlin.

Rockefeller explained his theory: "Just because a country is technically called Communist doesn't mean that a capitalist institution such as the Chase Bank can't deal with them on a mutually beneficial basis, and, indeed, we do deal with most of the so-called Communist countries of the world on a basis that has worked out very well, I think, for both of us." Thomas C.

William J. Quirk, a contributing editor to TNR, is a professor of law at the University of South Carolina Law School.

Theobald, head of Citibank's international division, said simply: "Who knows which political system works? The only thing we care about is: can they pay their bills?"

The bankers were nominally Americans, but their political principles were those of the new supranational class of which they were members. The new class, rootless and parasitic, gathers annually at meetings of the International Monetary Fund. In 1979 the I.M.F. met in Belgrade, Yugoslavia. David Rockefeller's Chase Bank gave a cocktail party for a thousand friends and clients from all over the world. As the cocktails flowed, Bill Moyers, who had flown over with David in the Chase jet, asked a Chase aide what was going on. It's simple, the aide said. These people had gathered to "reaffirm, well, a feeling that they're part of the real global elite, which is, after all, what they are." These people, he continued, "place the limits, in effect, on what any sovereign nation can do."

On the way home, the Chase group stopped over in Rome to visit some clients at the Vatican. As he stood in St. Peter's Square, Moyers reflected, "Men like David Rockefeller move beyond religious, political, cultural, national boundaries with great ease. And here in St. Peter's Square, the heart of the Roman Catholic faith, there's something very symbolic to me about that. The Church has always transcended national, political, and cultural lines, and so, in its own way, does the universal church of Money. It goes where it will, and the laws of no single country can regulate it."

TO MAKE MONEY, the bankers must keep it moving. The West's wealth, controlled by the new elite, was up for grabs. The Arabs, to get their share, also went to history, but they didn't have to go as far back as Peter the Great. After World War I, the English and French imposed reparations upon Germany that the Germans couldn't pay. The English and French owed war debts to the U.S. that they said they couldn't pay. The U.S. had plenty of money. American bankers, with stunning ingenuity, came up with a scheme to get the American public to pay the German reparations. The bankers sold German bonds to the American public; the proceeds, minus fees, went to Germany, which paid England and France, which paid the U.S. Treasury. One hundred and fourteen German bond issues were sold here; the new loans paid the interest on the old, and the reparations, too. The German game was going so well the bankers peddled to the American public the bonds of other foreign countries, including Argentina, Bolivia, Brazil, Bulgaria, Chile, Costa Rica, Ecuador, Mexico, Peru, and Rumania. By 1933, $25 billion of foreign bonds were in default. The bonds the bankers sold to U.S. investors turned out to be gifts from U.S. investors.

The bankers made no apologies for selling the bad bonds to the public. They explained to the Senate Finance Committee in 1931 that they were just doing their job. Charles E. Mitchell, chairman of the First National City Bank, testified: "With respect to the bonds generally, we are merchants." Thomas W. Lamont of J. P. Morgan & Co. supported Mitchell: "We are merchants. That is what we are, just like any merchant, in the grain business, in the cotton business, or anything else." As one witness told the Senate Committee on Manufactures, "I do not think you would be justified in holding the bankers responsible for the wide speculative craze that worked through the country. I think we were trying to supply what the customer wanted . . . I think the banker is like the grocer. He supplies what his customer wants."

Memories, even the most bitter, fade. By 1973 the bankers were ready to try the same game again. Again, the U.S. had most of the money. This time the money was pumped from the U.S. to poor countries who passed it to the Arabs who passed it back to the banks. The money transfer was tremendous. In 1972 the Arabs received $24 billion from the rest of the world. In 1982 they received $230 billion. Since all oil prices followed OPEC's lead, in the U.S. the cost of oil went from $20.3 billion in 1972 to $225 billion in 1981. The extra cost came to $820 per person, or $3,300 for a family of four. The Arabs, with the banks brokering the deal, had made a major withdrawal from the West. The public was told that OPEC had control of the world's energy and could charge what it liked. The OPEC surplus started slowly at $25 billion a year; by 1980 it was rolling along at $110 billion; in 1981 it was $90 billion. In 1982, having induced a worldwide recession, the surplus disappeared.

The current "lifting cost" of a barrel of Saudi crude is 50 cents. Even at 1972 prices, $2.50 a barrel, oil was a fantastically profitable commodity. Beginning in 1973-1974 the Arabs, with the bankers' cooperation, became tax collectors. The tax was collected in the form of payment for the oil, say $4 for the oil and $30 for the tax. They sought simply to extend their corner on oil to all of the West's capital and real wealth. The West, its economic sovereignty rapidly eroding, made no response.

POOR COUNTRIES, of course, could not pay the new tax. They have run trade deficits for as long as anyone can remember and will for as long as anyone can foresee. The ingenious solution was "recycling." The banks loaned the money to Zaire so it could pay its tax to the Arabs who then deposited the tax collections back in the banks. The parties thought the debt merry-go-round could go on forever. In year one the banks loaned Zaire enough to pay its oil tax, say $1 billion. In year two the banks rolled over that billion and had to loan enough new money to cover year two's oil tax, say another billion, plus the interest on the outstanding debt, say $200 million. The geometric progression of compound interest worked heavily against the poor countries. The borrowing had to increase, and increase at an accelerating rate. Within a few years the figures were outlandish. Mexico, for example, owed, in interest alone, $250 million *a week*. Brazil was about the same. The bankers had

disregarded the fatal weakness of a debt merry-go-round—that you can't get off.

Because of the basic principle of the merry-go-round, the debt balloons in proportion to the certainty that it cannot be repaid. Borrowing is needed increasingly just to pay interest rather than to finance imports. Mexico's debt jumped from $40 billion in 1980 to $80 billion in 1982; Argentina's shot from $13.7 billion in 1978 to over $40 billion when it decided to invade the Falklands; Poland, before Solidarity, ran its debt from $10 billion in 1976 to $27 billion in 1981.

The figures are beyond comprehension. In June 1982, according to Treasury Secretary Donald Regan, the poor countries owed $265 billion to private Western banks. Latin America alone owed $168 billion to the banks. Including loans from Western governments and international agencies, the poor countries owed $500 billion. Counting in loans to companies in poor countries, the total was $626 billion, of which $400 billion was owed to the banks. Even for a grocer, that's a lot of lettuce.

HALF OF THE POOR-COUNTRY debt is due in 1983. In 1982, $140 billion was due, of which $45 billion was not paid; twenty-two countries were forced to "reschedule"—a banker's euphemism for default. The debt is so short term because, as the merry-go-round accelerated—the second oil shock of 1979 gave it a good push—the bankers thought they could reduce their risk by making the loans shorter.

The bankers have been reassuring. They have borrowed a phrase from Abe Beame in the early days of the New York City crisis; the city was not bust, he said, it just had a temporary liquidity problem. Now, said the bankers, the poor countries with no money had a problem of liquidity rather than solvency. Further, the "liquidity problem arises," said Chase vice chairman William S. Ogden, "from the increasing unwillingness of the international financial community to lend."

In the foreign bond scam of the 1920s, the bankers were pure middlemen or brokers. The foreign governments paid them a fee for selling the bonds to the U.S. public. The foreign governments got the proceeds, the bankers got their commission and fees, and the U.S. public got the ultimate loss. The current recycling variations couldn't use bonds—the U.S. investors did remember that much. You couldn't sell them the bonds of Argentina, Bolivia, Brazil, and Bulgaria, to say nothing of Zaire, Zambia, and Poland. And it was unthinkable to try to sell Russian or East German bonds to Americans. The impossibility of bond sales forced bankers to become "committed middlemen." They took in Arab deposits and made loans to the poor countries. They are vulnerable both ways.

In September, Denis Healey, former British Chancellor of the Exchequer, called the Toronto meeting of the I.M.F. the "last chance to save the world from a catastrophe even greater than the slump of the 1930s." *The Economist*, in an article titled, "Not With a Bang But a Fonda" described "two theories of how the banking world could end: the big bang theory and the gradual-disappearance-down-a-black-hole theory." As in Jane Fonda's movie, *Rollover*, the big bang theorists postulate a major default, say of Argentina, which sets off a chain reaction of defaults in the highly interdependent banking system, collapsing it within twenty-four hours.

The black-hole theorists see a more gradual process driven by the poor performance of bank stock and commercial paper and increasing "tiering." "Tiering" means simply that lenders distinguish among banks based on credit quality; recent victims are the certificates of deposit of Chase and Continental Illinois. The banks themselves are beginning to discriminate in the critical interbank market—where Bank A, with extra funds, will loan to Bank B, which is short, perhaps because it just failed to receive $100 million from Argentina. Bank B, if it can't get an acceptable rate from Bank A, will slide gradually into a downward spiral of high rates for funds, lost deposits, and disappearing profits. Since the banks are all tied together by past interbank loans, each one slipping in will pull some others in behind it. The bankers, however, do not consider themselves at risk. They are confident that the U.S. taxpayer, like the bondholders of the 1920s game, will take over the loss.

Where was the money? The bankers had no idea. Could anyone find $27 billion in Poland? Or $40 billion in Argentina? Very little of the money could be traced to productive projects. Most went up in smoke covering balance-of-payments deficits. A fair amount seems to be in Swiss bank accounts with numbers belonging to Argentine generals.

DID THE WEST, and particularly the U.S., need the capital the bankers were giving away? Well, two M.I.T. professors recently estimated that 30 to 50 million jobs were lost during the 1970s as a result of plant relocations, closings, and contractions. The U.S., at an extraordinarily fast rate, underwent "deindustrialization," a process that will be fatal to the future strength of the country. The professors estimate that 70 percent of private-sector jobs existing in 1970 were gone by 1980. The bankers turned down meritorious domestic borrowers with the simple, unanswerable question: "Why should I lend money to you when I can make so much more lending to Mexico?"

The bankers have been no more prudent in their recent attempts to attract capital by wooing domestic customers away from the money funds. Because the banks are now paying such high dividends to their depositors, they will have to charge high rates to borrowers. Two things will happen: The banks will attract the least creditworthy borrowers, just as they did with the foreign loans; and inflation will rise.

Realistically, the foreign loans don't exist anymore: they continue, however, to have a spiritual presence. The bankers will not write them off: loans to Poland, Zaire, Rumania, and Argentina are still counted as assets

of the banks. Although they have not the weight of a wisp, they continue to balance the books.

For the bankers have created a fictional world where the loans are still good. No country, according to the bankers' new definition, is bankrupt unless it can't borrow to pay the interest anymore. The bankers and poor countries have had a mutual interest in maintaining the fiction. The poor countries, if they told the truth, wouldn't get any more money. The bankers, if they told the truth, would have to write off almost $400 billion of bad loans. But reality is breaking through: now the interests seem to be diverging as the poor countries look ahead to fifty years of I.M.F. servitude to pay off foreign bankers.

The bankers are now caught by the basic principle of the merry-go-round. Not only can you not admit past errors, you have to keep lending ever-increasing new money. The Russians project they will need the West to provide a new $70 billion for Comecon by 1986. The third worlders will need at least $80 billion a year.

The bankers said the solution was more lending. In their view, the most dangerous threat to the world's financial system is a major retrenchment in international bank lending. "The problem," said a former senior officer of the New York Fed, "is that there are psychological concerns about the creditworthiness of countries and banks that loaned to these countries." David Rockefeller agreed the problems were psychological: "Most of the international banks have been cautious in what they've done. Even in a situation like Mexico, I don't see any risk of ultimate loss." Chase vice chairman William S. Ogden emphasized, in an article in *The Wall Street Journal*, "There is a *negligible* risk of permanent default." This exact phrase appeared a month later in the testimony of Treasury Secretary Regan to Congress—without the italics and without attribution.

THE BANKERS' fictional world is contrary and perverse. In the bankers' strange world, insolvent debtors demand more money and dictate terms to the lenders. "The super-debtors," Mexico, Brazil, and Argentina (who together owe $250 billion), are able unilaterally to "reschedule" their debt. Poland and Rumania have done the same thing.

In the second half of 1982, Secretary Regan testified, U.S. regional banks (all of those except the largest) "have sought to limit or reduce exposure." To the extent they are successful, the Secretary added, "they place a greater and disproportionate strain on the resources of the larger banks and official lenders that are committed to the international financial system." The big banks—who had been laying off as much as possible on the regionals—were crasser in their criticism. The regionals, they said, were eager enough for high returns while things were good, but now, at the first hint of trouble, they had run for cover. Jacques de Larosiere, managing director of the I.M.F. (which is itself almost out of money), lectured the regionals that they should evaluate each loan "flexibly and pragmatically, keeping in mind that a cooperative international effort will best serve the interests of all the parties involved and, ultimately, the financial system itself." What had the regional banks done to reap such a bitter and threatening harvest? It was simple. They had begun to act like bankers again. They were attempting to reassert discipline and sense in a world that would live only on fiction.

The losses, the banks say, should be shifted to the taxpayer. The whole deal had been set up to evade democratic procedures, but now that it has gone bad the taxpayer should pay for it. Indeed, say the banks, the taxpayer has no choice. He can pay now or pay later, but he has to pay. He can pay indirectly through the I.M.F. or the Federal Reserve, but he has to get dollars to Mexico so Mexico can pay Chase.

BOTH THE OFFICIAL Republican government and the shadow Democratic government agree with the bankers that the taxpayer must pay. For the shadow government, Felix Rohatyn, New York financier and fabricator of the New York City voodoo economic bailout, is the advance favorite to be Secretary of the Treasury when the Democrats get back in. He recommends a new Reconstruction Finance Corporation to take over the bad loans—in essence, the federal government would bail them out. He recently wrote that the "mere existence" of his new R.F.C. "would help remove the widespread concern about the soundness of our banks, which is clearly detrimental to an economic recovery."

The official government takes a similar tack. In a November speech in Boston, Federal Reserve Board Chairman Paul Volcker told bankers to keep lending: "New credits should not be subject to supervisory criticism." In December the Administration asked Congress to appropriate $8 billion for the I.M.F. Treasury Secretary Regan, in testimony to the House Banking Committee, denied that the idea was to bail out the big banks. Far from it, he said: "Our efforts are primarily in defense of the average American and his own economic interests." How will the average American benefit from keeping the merry-go-round going? The Secretary described the bleak result if the U.S. and major Western governments "follow a 'hands-off' approach to the debt problems." He believed that the banker would not supply new money unless the taxpayer chipped in, and, consequently, the "hands-off" approach "would most likely result in a cessation of new private lending to L.D.C.s [less developed countries] in general." Since they had received $45 billion of new bank loans in 1981, a drop to zero would deprive them of $45 billion of purchasing power. Without a new $45 billion of new loans, they could not buy $45 billion worth of goods from the industrial West. The Secretary testified: "This would represent a direct loss of 0.3 to 0.5 percent of G.N.P. in the industrial countries; secondary effects could double that loss." In the U.S., "growth would be about 1 percent less than we're expecting, and our trade

deficit would grow very rapidly." That's what the "hands-off" approach would get you.

Many people who voted for Ronald Reagan thought they were voting for the "hands-off" approach, which during the election campaign was known as "getting government off the backs of the people." Times change, and the Administration has adopted a particularly perverse Keynesianism, under which you have to give poor countries money so they can buy goods from you. (Poor American people, of course, do not qualify). Giving huge sums to Arabs and third world countries and to the Soviets creates demand. These welfare recipients will buy U.S. goods, creating jobs, and so on. Of course, this is exactly what the bankers have been doing since 1973.

The second bad result of the "hands-off" approach, the Secretary testified, is that the banks will have to recognize some losses. What happens, he asked, "if foreign borrowers do not receive sufficient assistance to adjust in an orderly way?" What if they can't pay the banks? American workers in "Providence, Pascoag, or Woonsocket" are then, he said, in real trouble. He posed, hypothetically, a sound, well-run U.S. bank of $10 billion in assets (loans) which has $600 million of capital. Regulators require the bank to maintain at least $6 in capital for every $100 in assets. "What happens if 10 percent, or $60 million, of its capital is eroded through foreign loan losses? It must contract its lending by $1 billion." The net result is that $1 billion in loans can't be made in that community—20,000 home mortgages at $50,000 each that can't be financed, or 10,000 lines of credit to local businesses at $100,000 each that can't be extended.

Republican perversity was now building up. A loss plainly exists, but if we don't cover it up, if we recognize it, the insolvent bank will have to cut back its lending. Families will not get housing and business will not get needed credit. They will get houses and credit if the taxpayer gives money to the I.M.F., which gives it to Mexico, which gives it to Chase. The Reagan Administration is about to propose giving another $7 billion to the I.M.F. The American in Pascoag is probably not sophisticated enough to understand why that's good for him.

The Secretary's hypothetical example demonstrates how pathetically thinly capitalized the U.S. banks are. The regulators only require capital equal to 6 percent of loans, which leaves very little room for error. In 1930-1933, when 7,000 banks failed, capital requirements were much higher. Today, the exposure of the twelve major banks in Mexico and Argentina alone exceeds 100 percent of their capital.

The Secretary's most appealing pitch is that he is just trying to buy some time to give the economy a chance to come back. Everything is basically all right, but the system just needs a little time to make some "orderly adjustments." Indeed, "there is a negligible risk of permanent default by major sovereign borrowers." (There's the phrase apparently borrowed from the vice chairman of Chase.) "Permanent" default is a new financial concept that the Secretary did not bother to define. While the risk is negligible, "some net new lending will be required" to permit the "establishment of economic adjustment programs in key borrowing countries."

The I.M.F. works closely with governments in order to "help identify the causes of their economic problems and to identify the appropriate economic policy adjustments." Together, they develop a stringent program to restore domestic and external health. Usually the program includes higher taxes, less spending, lower subsidies for food, lower subsidies for industry, and currency devaluation—all designed to increase exports and reduce imports. In a word, austerity.

A Mexican peasant may think things are pretty austere already. He may think the I.M.F. program is designed to secure funds for foreign bankers. The problem is that the I.M.F. programs do what they are intended to do. They increase unemployment, reduce growth, and lower a standard of living that is marginal to begin with. Third worlders say, "An application to the I.M.F. is a recipe for a coup d'état."

ALL THIS MIGHT go down if the Mexicans or Brazilians or Argentinians thought the debt was fairly incurred to begin with. But it's very clear that they don't think so. Not unreasonably, they think they are victims of a lot of horsing around beyond their control. They couldn't stand up to the Arabs, but the U.S. could and didn't. They think at least half the debt is not real debt, but unconscionable interest that has piled up because of a U.S. experiment with the theories of Milton Friedman. Much of the borrowing was by corrupt regimes for their own purposes, which included oppressing the people now asked to pay. Almost all the loans were made by bankers who must have known they were far beyond the capacity of the country to repay.

The continuing erosion of Western wealth to keep in power Communist governments who threaten our liberties is suicidal. The last argument on behalf of the merry-go-round is that if it stops, a lot of players will get scrambled. Without question, many governments will be shown the door by their people. But failed governments should be replaced. The U.S. has no interest in stabilizing Communists, military dictators, and other rulers whose people don't want them. Propping up repressive regimes on the chance they may cooperate with the bankers is not an American aspiration. Nor is the use of U.S. government muscle to collect bad loans for bankers.

The bankers say it is not their mistakes that have caused the trouble. In their view, the world has been inundated by a series of great waves. Impersonal forces, beyond anyone's control, produced inflation, recession, high interest rates, high oil prices, and low commodity prices. In fact, actual, identifiable people took specific actions that had predictable results. These men are responsible for the natural consequences of the decisions they made.

The following statement on the International Monetary Fund was adopted by the AFL-CIO Executive Council on February 24, 1983 at Bal Harbour, Florida.

INTERNATIONAL MONETARY FUND

AFL-CIO Executive Council

The current international debt crisis requires far-reaching and comprehensive arrangements based on close cooperation of all the countries concerned. Piecemeal measures which aim primarily at alleviating the current crisis will not prevent further proliferation of potential defaults.

Congress has been asked to approve United States participation in a 40 to 50 percent expansion of the International Monetary Fund, of which the U.S. share would be about $8 billion. This would be in addition to an expansion of the General Agreements to Borrow (GAB) special IMF fund, which requires about a $2 billion U.S. participation.

Such an expansion of IMF lending authority is being proposed to help greatly indebted nations, such as Mexico, Brazil and Argentina, with further credit extensions so that they do not have to default on large outstanding debts.

The creditors are not just sovereign countries, but also, to a very large extent, private U.S. and foreign banks. Although the banks and the IMF might, in the immediate future, have to extend more credit to the debtor countries, they would in the long run avoid losses of large sums of money presently owed to them.

The Federal Reserve Board and the central banks of other countries have largely surrendered to the commercial banks the responsibility for oversight and control of international lending.

When the IMF extends credit to hard-pressed debtor nations, it usually requires that certain conditions be met by the assisted country, cutbacks in social programs, tight monetary policies and the adoption of policies to increase exports and decrease imports so that foreign exchange gains can be made to help repay debts. In the process, trade and employment are injured in the United States as well as in all free world nations.

The AFL-CIO recognizes the serious consequences of potential large debtor nation defaults to the world economy and the need for IMF action to help debtor nations out of their precarious positions. It also recognizes, however, the cost in dollars to the U.S. taxpayers and in jobs to U.S. workers.

The AFL-CIO supports U.S. participation in an expansion of IMF capital funds provided that legislation is enacted to accomplish the following:

★ The IMF should require private banks that have extended loans to foreign borrowers to share in the costs and burdens of any "rescue" efforts.

★ IMF resources should not be used to reschedule and recycle the debts of totalitarian regimes and those that abuse human rights.

★ The Federal Reserve Board should be required to increase reporting and surveillance of U.S. bank foreign lending and to restrict such lending, with due consideration of the impact of credit availability and cost to the U.S. economy, as well as the capability for repayment.

★The Federal Reserve Board should be directed to require special U.S. bank reserves against foreign lending, and such reserves should be available to provide a part of future U.S. contributions to IMF fund expansion.

★ The Federal Reserve Board should be required to report regularly to the Congress on the volume and terms of foreign credit extension by U.S. banks, on the quality of such credit, and on the effects of such credit extention upon the U.S. economy with respect to international trade positions and the availability and cost of credit in the United States.

★ The Secretary of the Treasury should be directed to seek change in IMF policies to reduce emphasis upon the development of excesses of exports over imports and to place more emphasis upon balanced economic growth through development of broader domestic markets and improved income distribution.

LEADING MEXICAN SCHOLAR SAYS IMF AUSTERITY PROGRAMS ASSURE ECONOMIC STAGNATION

Dr. Modesto Seara Vazquez, President of the Mexican Association for International Studies and a democractic socialist, recently made these remarks in an interview published in World Policy Forum (Spring 1983):

"Forum: The IMF and other international financial institutions believe that the causes of the economic crisis in Central and Latin America are due to financial mismanagement. Doesn't the imposition of austerity measures as a part of loan packages exacerbate the problem of marginalization?"

"Seara: I do not agree with the policies of the IMF, but I do agree with a policy of austerity. The policies of the IMF are not only those of austerity, but also those of stagnation. A policy of non-inflationary expansion, with a careful redirection of existing resources, is not only a positive austerity program, but it is also the only way to avoid stagnation and social upheaval. The IMF's policy of austerity, by lowering the level of economic activity, makes it even more difficult to repay debts. The IMF's austerity policy then is a contradiction: it makes it more difficult for a country to repay its debt and it fuels social unrest."

DAVID STOCKMAN SPEAKS OUT ON IMF QUOTA BILL

"This is bad legislation . . . Proponents argue that the IMF needs this increase to help prevent economies in the Third World from collapsing under the burden of excessive external debt and thereby becoming vulnerable to communist takeover or subversion. But the IMF does not have a record of success in strengthening unstable economies in the Third World. Indeed, it has been counterproductive."

"In a special internal analysis, the IMF has itself admitted that less than one third of its programs have been successful in improving Third World nations' balance of payments positions. But those programs have been very successful in impoverishing less developed countries."

"In this time of economic stringency, when federal deficits are placing heavy borrowing requirements on the capital markets of this country, the American public should not be called upon to fork over $5.5 billion to the IMF."

Rep. David Stockman
July 21, 1980

Chairman James Dale Davidson of the National Taxpayers Union presented the following testimony to the Subcommittee on International Trade, Investment, and Monetary Policy of the House Banking, Finance and Urban Affairs Committee on May 3, 1983. His testimony is particularly useful in discussing the IMF's options for using its gold stocks, and for pointing out the tension between IMF's role as international credit bureau and its role as lender of last resort.

MORE IMF LENDING: GASOLINE ON A RAGING FIRE

James Dale Davidson, Chairman
National Taxpayers Union

Since 1977, the National Taxpayers Union has warned that the mounting debts of Third World and Iron Curtain countries would not be repaid. Unfortunately, our views on this subject have proven far more accurate than the self-serving projections of the banking community and those of the great majority of acknowledged experts in international finance and development.

We were critical of the Carter Administration at the time of the last IMF quota increase — which was to have sufficed until 1985. Now Reagan is following in Carter's footsteps. The Administration has recommended yet another giant infusion of taxpayer funds to subsidize and preserve the current relationships in international finance. This is like pouring borrowed gasoline on a raging fire — a policy which is flawed several times over.

It is flawed in the first place because it arises from a misdiagnosis of the problem. Making more money available will only increase the overall burden on the debtor countries, bringing nearer the day of outright repudiation and default.

Yet even if this were not the case, and it were wise and necessary to increase the funds available for concessionary lending by agencies such as the IMF, it would still be ridiculous to borrow $8.4 billion out of an empty pocket when the IMF is now hoarding more than $50 billion in idle assets. The IMF, if it so desired, could raise mountains of cash without resorting to the U.S. Treasury. But apparently, the received view in this town is that subsidizing the mistakes of big banks and central planners everywhere is such a pressing public concern that it should be done on the full faith and credit of the U.S. Treasury, thus enlarging an already ghastly and growing federal borrowing requirement.

To repeat: The IMF does not need to dip into the U.S. Treasury to raise cash. It has at least three other alternatives open to it:

1) It could borrow directly in capital markets. It already has that authority.

2) It could decide to discount some of the $23.5 billion in sovereign loans it currently holds. If it is true, as advocates of more lending allege, that the debtor governments are solid long-term credit risks now suffering through temporary "liquidity" difficulties, then even the complicated legal form of IMF loans would not keep them from finding buyers in the market.

3) The IMF also could raise cash by selling some of its $50 billion hoard of gold. Why is this obvious expedient deemed unacceptable? The answer seems to be, in part, that selling gold would lower its price, and thus be a setback to the government of South Africa. The IMF has recently lent yet another $1.1 billion to South Africa, money which, in essence, went to help that government maintain its gold price support program. Quite apart from the moral problem of subsidizing an apartheid system, it is plainly objectionable to worsen a great federal deficit just so that a foreign government can heavily subsidize its mining industry.

In short, the IMF can raise the cash it needs to finance concessionary lending without additional subsidies from the American taxpayer. That said, however, there is no compelling reason to believe the IMF even needs more cash, no matter what its source. Since the abandonment of fixed exchange rates, the IMF's original function of financing temporary balance of payments difficulties no longer exists. Its present self-appointed role as a lender of last resort serves one purpose only — to funnel indirect handouts from taxpayers to bail out imprudent commercial banks and their customers among Third World and Iron Curtain governments.

Some have argued that the IMF can serve a valuable function in the world economy by imposing stringent conditions for further lending and thus help borrowing countries accept politically unpopular changes in economic policies. If the policy conditions imposed by the IMF were not merely unpopular but also promoted economic efficiency, then the IMF would indeed be providing an important service. But whether it is in fact doing so, and if it is, whether it needs additional cash to perform that role, are entirely separate questions.

My personal view is that, on balance, the IMF is probably contributing more to the build-up and preservation of obstacles to trade and economic efficiency in the world economy than its stabilization programs are eliminating. It should not be forgotten that many, if not most, of the policy difficulties of the borrowing countries are difficulties of their own making. This is a point which should be emphasized. Economic growth is not an accident of nature. It is a consequence of human choice. Any country can impoverish itself by maintaining overvalued exchange rates, subsidizing foodstuffs and thus destroying domestic agriculture, erecting corrupt and inefficient state enterprise to monopolize industrial development, and imposing domestic fiscal policies which push aggregate expenditure above output.

The presence of the IMF as the lender of last resort has encouraged commercial banks to lend more money in support of governments with such inefficient policies than they would have done without the prospect of a bailout. The IMF, with cash in hand, can keep sovereign debts on the books of banks from going bad. It thereby contributes to the false impression, so boldly stated by Walter Wriston, that "countries don't go broke." Bankers who believe this will weight their portfolios toward foreign sovereign debt and away from private sector debt, with the result that countries with anti-competitive policies will obtain far more resources to sustain those policies than would have been the case in the alternative. Thus, the world economy will be worse off than it would have been had bad political policies been left to stand on their own in the world marketplace.

An IMF with less cash would be less able to perform a bailout function. But it needs no cash to impose a stabilization program. Only a travel budget. There is no reason to believe that the imposition of the IMF conditions for further lending must be accompanied by concessional loans from the IMF. The record clearly shows that acceptance of an IMF program has historically opened wide the channels of commercial bank lending. If this is now changing, it may be due as much to the IMF's role as a lender of last resort as in spite of it. If the IMF had no money itself with which to enrich a payout from a reform program such a program would have to be as stringent or more stringent than present stand-by agreements to have the desired effect of opening access to capital markets — markets which were quite rightly closed in response to the poor management of the economies in question.

There is a contradiction between the IMF's role as a certifying agency and its assumed task as a lender of last resort.

This contradiction is certain to become more visible in the future as more nations prove unwilling or unable to pay their debts. If the IMF is to make its role as a certifying agency meaningful it cannot provide a "clean bill of health" to nations which have failed to live up to the requirements of their stand-by agreements. Yet if it is to bail out the banking system it must step in to ease any crisis of illiquidity, no matter how it was caused. The greater the amount of cash at IMF disposal, the greater the temptation to use it in bailouts must be. And, ironically, as the IMF's role as a lender increases, its value in certifying the soundness of economic policies must decrease. Perhaps this helps to explain why more than two-thirds of the IMF stand-by agreements scrutinized in one recent internal IMF study were found to be failures.

When a nation has declined to live up to its share of a stand-by agreement, the IMF's response has been to offer more cash and yet another agreement. But there is a limit to how long this process can be extended without emptying stand-by agreements of all credibility. For example, it seems highly problematic that Mexico will meet the terms of its most recent IMF agreement. When this leads to yet another crisis, as it seems bound to do, does this mean that the IMF will not take a hand in pressing more cash into the Mexican coffers? Or will it once again be the leading party to the bailout, and in the process reduce to nonsense the view that borrowing countries must adopt sound policies to gain further credit? My own guess is that the second outcome is more likely.

If the IMF prefers to be a lender of last resort, as its current quest for cash implies, the resulting devaluation of its certifying function will lead to a deterioration of world economic policy, reduced lending on a commercial basis, and an increased burden upon taxpayers in western countries as yet more official flows are sought to bail out banks and their cash poor customers.

The best way for the IMF to serve a positive role in resolving world financial difficulties is for it to serve as a monitoring agency only. The more the allocation of credit is left on a market basis, the sounder will be the resulting policies. Not because Third World and Iron Curtain politicians will suddenly prefer sound policies, but because the cost of sound policies relative to the cost of unsound policies will have been lowered.

In the last analysis it is wrong to suppose that a difficulty brought on by too much lending can be solved by yet more lending. . . . Rather than dealing out yet another hand to be stacked on international banking's house of cards, we should take care, and look to the long run, to the real sources of economic growth and prosperity. These lie in policy adjustments by the borrowing countries, and not in subsidized lending. Rather than pouring good money after bad, at the expense of taxpayers, we should look to the strategic and geo-political factors which will really determine whether sovereign loans are repaid . . .

One further point: It would seem rather difficult for any congressman who votes to send billions to bail out big banks, and their customers among foreign governments, to then say "no" to any spending request from American citizens. Is the growth of Social Security spending to be curtailed so that Congress can lavish the savings on CitiBank and the Argentine dictators? Can we say "no" to demands to subsidize faltering American industries while sending billions abroad in roundabout subsidies to their nationalized competitors? Are we to cut back subsidized housing for the poor in America so the taxpayers' money will be available to keep subsidized housing programs afloat in Thailand or Mexico? Passage of the IMF quota increase makes a joke of any attempt to control spending domestically.

At a time when the U.S. budget deficit is running well out hand, it is not only economically but politically inadvisable to borrow $8.4 billion more for the IMF. In the first six months of fiscal 1983, the red ink totalled a staggering $129.2 billion. Secretary Regan has said, "We are tearing ourselves apart" with that kind of deficit spending. Isn't it time we got serious about solving that problem — rather than adding to it by trying to pay the overdue bills of other countries?

THE WALL STREET JOURNAL. April 30, 1983

What Debt Crisis?

The Reagan administration has been flogging Congress to add $8.4 billion to International Monetary Fund coffers as the key element in a plan to quell the "debt crisis" that is said to be threatening the world financial system. But we have been watching with a rising sense of unease as the legislation wends its way through Congress. Many questions about the IMF scheme have gone unanswered. One is: What debt crisis?

To us, it appears that the international debt crisis, as conventionally defined, is for all practical purposes over. The chief element in that crisis was what bankers at the time were pleased to call an "unexpectedly" severe recession. To our mind, bankers are paid to expect the unexpected, but let that pass for a moment. There's no doubt that less-developed countries were finding it more and more difficult to export their goods to the industrialized countries and thereby generate enough revenue to meet their debt service. The length and severity of the recession supposedly made it necessary to arrange an emergency fund to stave off an old-fashioned banking panic.

But now most of the industrialized countries are well on their way to recovery, judging from the official indicators and ebullient stock markets world-wide. Government economists reportedly have run the recovery scenario through their computers recently and found that 4.2% growth over the next two years, which looks very much in the ballpark, would pretty much solve whatever debt problem exists..

That's not to say that some countries, and some banks, couldn't still go down the tubes. But the market has had ample time to discount the probability of this, and there's no reason it should lead to a panic. Poland has already declared a virtual moratorium on repayment of its debt, and that didn't lead to financial Armageddon, as some predicted. Anyway, there are established national procedures for dealing with potential bank failures.

And if a crisis really does exist, the IMF is sitting on about $45 billion of gold that could be pledged to raise more than enough hard currency to deal with it. The proposed quota increase, by contrast, wouldn't take effect until late this year. That doesn't sound like much of an emergency to us, although it does sound like a way of permanently augmenting the power of the IMF bureaucracy.

Cooler heads have all along been skeptical about the true extent of the "debt crisis." A confidential Federal Reserve/Treasury Department staff study last summer concluded that "a collapse of the system is highly unlikely (although) there is always the danger that an individual borrower, or borrowing country, will run into difficulties." Only in the cases of Mexico and Brazil, the study said, "is the magnitude of U.S. banks' exposure sufficient to pose a potential threat to confidence in the event of total loss." But, the study quickly added, "total loss . . . is highly unlikely."

That was a good judgment then and it's good judgment now. At the very least, it makes it incumbent on the administration and the IMF to make a more positive showing why huge new sums of money must be taken out of our capital markets, guaranteed by the taxpayer and flung at countries around the globe with proven records of poor economic policies. It also hasn't been made clear by the administration and the IMF why adding more debt to the backs of poor countries will help rather than hurt them. Or how it will help the soundness of the banking system to be "bailed in" for billions more in shaky loans to whomever the IMF's bureaucrats deem worthy. The IMF has had some successes in recent years, but most of its customers seem to come back again and again for more money.

Debtor nations, bankers, IMF officials and others with a vested interest in bailouts like to scare the public with such specters as the $600 billion or so owed to the industrialized world by the non-OPEC developing countries. But only a fraction of that total is in doubt, and even that amount will be reduced by the economic recovery now taking place. The banks themselves seem in no hurry to raise their reserves substantially against the calamity supposedly stalking them.

The banks have been pushing for a higher IMF quota as a means of ultimately extricating themselves from this morass. But they are likely to pay a heavy price. Congress is working on companion legislation that would, among other things, restrict bank lending abroad. But development lending is by no means intrinsically a bad thing. Done properly, it can be vital to the health of less developed countries, as it was to the U.S. in the 19th century, and quite profitable for prudent banks. Doubtless many bad loans were made to developing countries, in large part out of belief that the IMF would in fact bail out the banks if push came to shove. This problem does need to be addressed, and rushing to add to IMF coffers is scarcely the way to start.

We said recently that we knew the recession was over because Congress was enacting a jobs bill. It now looks to us as though the international "debt crisis" is over because Congress is whooping through an increase in IMF quotas. Crisis legislation invariably turns out to be bad legislation, and it would be a good idea to put the quota increase on hold until we can start to understand our recent experience, and define what the international debt problem is and what it is not.

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The following commentary by Rep. Byron Dorgan (D-N.D.) was distributed by Pacific News Service (604 Mission Street, San Francisco, CA 94105) on April 15, 1983. Copyright PNS; reprinted with permission.

"DR. JEKYLL AND MR. HYDE LOAN POLICY - KID GLOVES FOR BIG BANKS, IRON FIST FOR SMALL FARMERS"

By. Rep. Byron Dorgan (D-N.D.)

With some fanfare, the Reagan Administration is beating the drums for an $8 billion bail-out of big New York banks on unwise loans made to countries like Mexico and Poland. Less well known is the fact that banking regulators — including Federal Reserve Chairman Paul Volcker — have been leaning on U.S. banks to continue lending to these countries.

In a speech last November in Boston, the nation's credit and interest rate czar offered bankers a deal: If they continued to prop up their foreign debtors, federal bank examiners would act like cops who catch the Mayor double-parked, and look the other way. Obviously, this was good news overseas.

There wasn't much comfort in the American farmbelt, however where farm debtors and their bankers are both losing sleep, and where the federal regulators are taking a very different approach.

In recent months, bank examiners have been fanning out across the rural countryside, pouring over the books of small-town banks and are warning community bankers to get tougher town banks and "picking the credits apart," as one North Dakota banker put it. They are warning community bankers to get tougher with farmers who are behind on their loan payments. Enough such "classified," or problem loans, and the feds can even put a bank out of business.

The regulators deny that a crackdown is underway. "If anything, we are being more lenient," one told me here in Washington. But that's not the message being heard in the farmbelt. "Those examiners very definitely have gotten word that they have to look harder at agricultural loans," a banker in Texas said.

Bank examiners are as tight-lipped a bunch as you will find, but one did admit to me that there has been a marked increase in "classified" farm loans in recent months. At the recent Independendent Bankers meeting in San Diego, local bankers spent more time discussing this problem than they did the dread plan to withhold federal income taxes on interest.

It's all pretty hard for these bankers to understand. Many have been walking the last mile to carry their farm borrowers through difficult times. To be sure, self interest plays a part, but there's a lot more to it than that. "These guys sit next to you in church," a Wisconsin banker explained. "You've cooked all those chicken barbecues, eaten the smoke with them for years."

With all its talk of "voluntarism," one would expect the Reagan Administration to be applauding these bankers as examples of what is best in America. Instead, it seems to be closing the window down on their thumbs. Making matters worse, in June federal regulators will begin making public the total amount of "problem" loans at all banks insured by the Federal Deposit Insurance Corporation. This will cause little distress at big banks. With Uncle Sam bailing out their bad foreign loans, they probably will be spared most of the embarrassment of disclosure. It's the local community bankers who are going to be left with their problem farm loans exposed for all to see — and feeling yet more pressure to foreclose.

Nobody denies that many farmers are in financial trouble, or that federal bank examiners have a responsibility to prevent things from getting out of hand. But the deeper issue is the administration's blatant double standard. How can the regulatory crackdown on farm loans be justified, when Mr. Volcker is telling bankers that the feds will go easy on foreign loans that are no less shakey?

The administration also warns that if we don't bail out foreign loans, we risk a repeat of the international banking collapse of the Great Depression. But let's not forget that it was the slumping farm economy of the '20s and the defaults and foreclosures that followed, that set the Depression's vortex spinning.

Nevertheless, the message from the White House is clear: If you lend your money to farmers and hometown businesses here in America, you are on your own. If you lend your money to foreign countries, the government will stand behind you. It's risk-free enterprise for Wall Street while Main Street gets the rigors of the marketplace.

What makes all of this especially hard for farmers to swallow is that they provided part of the money the big banks are lending to the developing countries. Most of that money is in petrodollars — deposits made by the OPEC countries since their enormous price increases in the '70s. Farmers, for whom the cost of diesel fuel alone has jumped over 600 percent since 1967, have provided their share and more of these petrodollars, which are now being recycled elsewhere via the New York banks.

Meanwhile, the administration is also pushing to "deregulate" the banking industry, which means letting big banks jump at will across state lines, and allowing giant companies such as Sears to become financial "supermarkets." When folks in small town America put their money into a Sears or Citicorp automatic teller, how much of it is likely to find its way back to the community in the form of loans to local farmers and small businesses?

Family farms and rural communities have given Americans the most stable and productive agriculture in the entire world. Yet our banking and credit policies are pushing those farmers into bankruptcy, and leading us toward a kind of centralized, top-heavy agriculture that has proven inefficient wherever it has been tried.

The federal government can tinker with tax laws and spending programs; it can enact "incentives" and "enterprise zones" until it's blue in the face. But in the end, little can be done about economic difficulties without the glue of community spirit. Many community bankers have been showing precisely this spirit. The administration should not complain about greater demands for government spending programs and relief, when it turns its back on the kind of community self-help which is the only practical alternative to the welfare state.

The Interreligious Task Force on U.S. Food Policy is a coalition of more than two dozen national Protestant, Roman Catholic, Jewish, and ecumenical agencies "who seek together to secure bread and justice for all members of the human family." Task Force Chair Paul Kittlaus of the United Church of Christ presented the testimony excerpted below to the Subcommittee on International Trade, Investment and Monetary Policy of the House Banking, Finance and Urban Affairs Committee on May 3, 1983.

COMBATTING DEVELOPMENT FAILURE: NOT MORE IMF LENDING, BUT A NEW APPROACH

Interreligious Task Force on U.S. Food Policy
Paul Kittlaus, Chair

The Interreligious Task Force on U.S. Food Policy *opposes* the request for an increase in the IMF quota in its present form. The proposed IMF quota increase is seen by many as an urgently needed solution to the debt crisis of developing nations which in recent years have reached unprecedented levels. We do not so see it. In the first place, we are not convinced of the *need* for a quota increase. In the second place, we believe that even if a need for a quota increase were demonstrated, providing that needed increase would be a serious mistake *unless* Congress at the same time stipulated significant changes in IMF approaches and policies. In this testimony we want to indicate why we doubt the need for a quota increase and to outline those changes in the IMF which we think Congress should require the U.S. representative on the IMF to demand.

Is an increased quota really needed?

No one doubts that all is not well in the global household. The administration's request for an increase in the IMF quota is evidence of that. Third World debt now stands at over $600 billion, and something clearly must be done. But is increasing the IMF quota the answer? We seriously doubt it.

For one thing, there is no solid evidence that the IMF needs the increase. The IMF has substantial resources to draw upon as well as the ability to create and raise billions of dollars. It has $8 billion immediately available in the form of lending resources; it has a large free, or unpledged, gold stock; the power to create new special drawing rights; and certain borrowing powers. In addition, the IMF holds approximately 100 million ounces of gold, worth $40 to $50 billion dollars, plus $8 billion in currency.

It has been speculated that if the quota increase were not provided, there would be an international economic disaster similar to the one in the 1930s. But this is not necessarily the case. Although nightmarish scenarios have been presented in the popular press lately, many reputable economists assure us that they need not be taken seriously . . . .

Finally, the administration has argued that the IMF quota increase is needed, among other reasons, to boost the employment rate in the U.S. Secretary of State Shultz, for example, argued in testimony in February 1983 that:

> *"According to one estimate, four out of five new jobs in U.S. manufacturing in the late 70's came from foreign trade. And 40 percent of our agricultural production is now exported. Yet reverses also occur. A crisis in its international finance has forced a draconian retrenchment on one of our major trading partners, Mexico. If the resulting $10 billion decline over 1982 in the annual rate of its imports from the U.S. were to be continued, it could entail the loss of a quarter of a million U.S. jobs—by one, conservative estimate."*

We find that such figures cannot be taken at face value. Job losses and decreased investment in some sectors could be compensated for by jobs and investments in other sectors. It is entirely possible that the resources currently involved in the manufacture of goods and services for export could be channeled instead into items being imported, or close substitutes. For example, television sets. In this case, manufacture of television sets could be resumed—providing employment for American workers.

A similar case can be made for the General Agreement to Borrow. Increasing the IMF pool now, as well as expanding the General Agreement to Borrow (GAB) could send the wrong message to debtor countries who could avoid, or fall back on their programs to manage their external debts. Private lenders would extend credit more readily with little chance of repayment. The problem would be put off, and not solved in the long run.

We would like to address ourselves to the issue of the expansion of the General Agreement to Borrow. When the Interim Committee on the IMF met in Washington, in February 1983, to discuss the international monetary crisis, two major decisions to deal with the problem were made. The first was the quota increase (from $67 billion to $99 billion) of 47 percent, of which the U.S. quota is $5.8 billion representing 18 percent of the increase. Second, it was agreed to expand the GAB which was originaklly set up by ten industrialized nations, as a backup line of credit, to be drawn upon solely by the ten contributing nations. In Paris, in January 1982 the Group of Ten (who manage the GAB) increased the GAB from $7 billion to $19 billion. The U.S. share of this expansion was $2.6 billion. Furthermore the GAB would be made accessible to any country whose liquidity problems would threaten the financial system as a whole. We feel that the expansion of the GAB would further encourage nations that have managed their economies poorly to borrow more.

It would also encourage nations that have not had prior access to the GAB to consider borrowing. It would certainly encourage the IMF to lend more than would be necessary. Once the IMF has made these loans, the commercial banks are more likely to support the IMF loans. As Secretary of State Shultz indicated in his testimony before the Senate Budget Committee in February 1983, "The IMF is a crucial part of the fundamental adjustment process. The IMF plays the essential role of helping affected countries develop sound policies of economic stabilization. Such stabilization policies in turn encourage new commercial lending. A Treasury study of the IMF programs establishes just this relationship. Over the last five years, IMF-supported stabilization programs have been followed by new bank lending that is on the average four times greater than the financing provided by the IMF. The IMF's financing does not pay bank debt, but rather encourages increased bank lending." This is precisely why IMF loans should not be made, as banks feel free to lend unjudiciously, and debt accumulates.

Thus, we are not all convinced of the need for the increased quota. But should Congress be persuaded of the need, we urge that it insist on certain changes in IMF approaches and policies as conditions of meeting the perceived need.

Changes needed in the IMF

Four changes are needed in the IMF's approach to the debt crisis and other problems of the developing nations. The IMF must take a much more holistic, global, balanced, and humane approach.

1. The IMF must take a much more *holistic* approach to the problems of developing nations, recognizing that monetary and fiscal policies are inseparable from overall development policies.

The increased debt of developing countries has many causes. A principal one is failure of current development policies. Countries have been encouraged to pursue development strategies that rely on foreign markets rather than on a strengthened domestic market. For most countries, this export-led strategy has required borrowing for longer periods and in far greater amounts than originally predicted. Hence, massive debts. Confronted with such debts, the IMF normally recommends tight monetary and fiscal policies. In so doing, the IMF tends to ignore the fact that monetary and fiscal policies are inseparable from development policies. Since its inception at Bretton Woods, the IMF has insisted that it is not a "development assistance" agency and has argued that assisting nations in their development is the role of the World Bank. But IMF recommendations surely affect development; and often, by recommending policies that will restore a foreign exchange balance in the short run, the IMF undermines the basis for long-term self-reliant needs-oriented development.

2. The IMF must take a much more *global and regional* approach to the problems of the developing nations, recognizing that national economic policies cannot reasonably be developed without due consideration of the interdependence of the global economy.

The IMF has been established to assist individual sovereign states. Although it deals with global economic problems, it does not propose global economic solutions. The Fund takes each country as a separate case and makes policy recommendations based on that nation's situation considered in isolation. In terms of its prescriptions, the Fund's focus on individual countries often leads it to recommend to those countries that they diversify their exports. But this does not take into account the fact that there may be several other producers in the market already established. The Fund has recommended to Sudan and Brazil that they increase their cotton and sugar production for export. But how many more cotton and sugar producers are needed? Moreover, in its focus on individual states, the IMF overlooks the possibilities of regional approaches that might enable several countries in a given region to develop a common or coordinated program to meet their needs.

3. The IMF must take a much more *balanced* approach, particularly in regard to food production.

In its eagerness to help a country secure more foreign exchange, the IMF often recommends increased agricultural production for export, regardless of what this does to the structure of agriculture within a given nation, or how it diminishes the capacity of a nation to produce sufficient staple food for its own people. The IMF's proposals to the Sudan are a case in point.

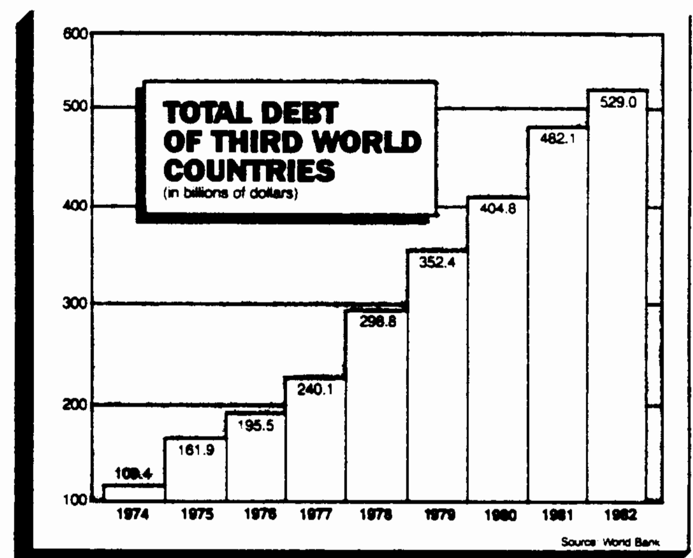
The Sudan is one of the poorest countries in the world and has perhaps the largest foreign debt in Africa, owing over $4 billion to foreign creditors. For the past several years, the Sudanese government has been relying on the IMF for help in dealing with its creditors. The IMF recommended increased emphasis on cotton production, so that the Sudan could earn more foreign exchange. Given the reality of the world market, it is questionable whether the Sudan will be able to increase its market share, and we wonder why the IMF prescribes such policy, which seems to be destined for failure. Furthermore, much of this cotton is produced on large scale irrigated farms. Given the constraints of Sudan's financial resources, increased attention to cotton means that small farmers will be hard-pressed for resources.

4. Finally, the IMF must take a more *humane* approach to the problems of the developing nations, taking care that its recommendations do not inflict needless suffering on the most vulnerable members of society.

All too often, the IMF's austere prescriptions result in seriously worsened situations for the poor. The monetary and fiscal policies imposed by the IMF frequently make operating capital inaccessible to small business operators and farmers, leading to higher unemployment and reduced food production. Wage controls without price controls erode the already marginal living standards of the working poor. Cutbacks in spending for essential social services (such as housing, health care, supplemental feeding programs, and education) often severely affect the majority of the population. Emphasis on increasing exports often comes at the expense of the domestic economy and consumers...

Conclusion

Urgent action is needed now for large-scale changes in global economic arrangements, in which countries of the north and south must both have a say. An opportunity for this presents itself in the immediate future at the Williamsburg summit and the UNCTAD meeting. Ours are not presumptuous requests. Congress is being asked to allocate a significant sum for the IMF. Just as a debtor country, in approaching the IMF, must be open to the IMF scrutiny and recommendations, so must the IMF, in approaching the people of the United States, be open to the scrutiny and recommendations of Congress. In the past, the IMF has responded to some problems of debtor nations by modifying its procedures and creating new facilities. We hope that at this juncture Congress will take the initiative by making the quota increase *contingent upon* the Fund's implementation of these recommendations.



How Threatening Is the World Debt?

By Robert E. Weintraub

The administration's proposal to add to the financial resources of the International Monetary Fund and General Arrangements to Borrow is being debated in a crisis atmosphere. Fears of a banking collapse and of dwindling exports depressing economic activity are widespread. But, in fact, there is no aggregate developing-world debt problem.

To understand why this is so, we need ask these questions: How big are the external debts of developing nations? Can they service them? What will happen to our banks if they don't? To exports? Is there a market mechanism to resolve the crisis?

The Organization for Economic Cooperation and Development estimates that the medium- and long-term external debts of non-OPEC developing countries totaled $520 billion at the end of 1982. (Debt with an original maturity of less than one year is excluded, since the short-term foreign assets of these countries—their deposits at the Bank for International Settlements—are about the same as their short-term foreign debts.)

Bank medium- and long-term loans other than officially guaranteed export credits were $182 billion, or 35% of the total. (The remainder consists of official development assistance, export credits, nonbank private lending, loans from multi-lateral organizations, etc.) When you consider what is actually a positive balance in the short-term accounts, the net bank "exposure," excluding the export credits, amounts to $159 billion, according to the OECD.

Loans Add Up to Billions

For U.S. banks only, Federal Reserve Board data show that, as of June 1982, adjusted for guarantees, medium- and long-term loans to non-OPEC developing countries *and the Eastern bloc* totalled $108.2 billion.

Even these smaller, bank-debt figures are dramatic statistics, but they are not meaningful ones. Banks are exposed significantly in some developing countries and hardly at all in others. Further, different countries have different capacities to handle debt. Debt, as the OECD points out, is "a phenomenon which manifests itself at the level of individual countries, rather than in aggregates and averages."

A country-by-country examination of U.S. banks' foreign loans shows concentrations to borrowers in seven non-OPEC developing countries: Argentina, Brazil, Chile, Mexico, South Korea, the Philippines and Taiwan. The exposure of U.S. banks in these countries was $79.5 billion in mid-1982. Among OPEC nations, exposure was over $3 billion only in Venezuela, where it was $10.7 billion. Among developed nations, the risk of default is considered trivial except for Spain, where it is considered low. Spain owed U.S. banks $6.7 billion at mid-1982.

South Korea, the Philippines, Spain and Venezuela were well able to service their debts in 1981-82, while Mexico, Brazil, Argentina and Chile had difficulties. Brazil and Mexico were the most financially strained. (Hard data are not available on Taiwan. Anecdotal evidence suggests it was not pressed.)

Banks are exposed significantly in some developing countries and hardly at all in others. Further, different countries have different capacities to handle debt.

Economic conditions have changed in recent months. The London Inter Bank Offering Rate (LIBOR), to which variable loan rates are tied, has fallen about seven percentage points. Although spreads between loan rates and LIBOR have increased somewhat, debtor nations will benefit from this. Mexico, Brazil and Argentina, which have high proportions of their total debt in floating-interest-rate loans, will be especially helped. Based on 1982 indebtedness, a one-percentage-point decrease in loan rates reduces Mexico's annual debt-service payments by $593 million, Brazil's by $455 million and Argentina's by $205 million.

Second, oil prices have fallen. This will decrease Mexico's and Venezuela's export earnings, decreasing their ability to service their debts, but it will increase the ability of other troubled debtor nations to service their debts, since their expenditures on imports will decrease.

Third, a moderate to strong recovery is under way from the recession that has afflicted developed countries. For most non-OPEC developing nations, this too will help.

Finally, debtor nations have taken "determined action" to increase their capacities to service their debts. Substantial exchange rate devaluations assure that they will increase their exports, attract foreign investment, decrease imports, and constrain consumption. (Monetary and fiscal discipline is now needed to validate the new exchange rates.)

At mid-year 1982, the total capital of U.S. banks was $66.2 billion. Loans to non-OPEC developing countries were 1.6 times capital. Defaults by Mexico and Brazil alone would wipe out 95% of the capital of the nine largest U.S. banks and 74% of the capital of the next 15 largest banks.

Although some banks might fail if there were defaults, there is no reason that banks should "fall like ninepins," provided that the Fed "furnish(es) an elastic currency," as it is charged under law to do, and that bank regulators use common sense in dealing with the loss of bank capital from defaults. Banks that hold defaulted loans on their books must be given time to write them off. The Fed must keep the money supply from contracting in the event of a run on banks. It has ample power to do that.

Should there be defaults, there would be less international lending and trade. We would export less. But it is easy to overstate this case and the damage. First, trade with most countries would fall only marginally. Second, trade with nations that default wouldn't be reduced to zero. Some trade-related financial arrangements would be continued. New ones, with creditors as yet not involved, could be started; the slates of debtor nations would be wiped clean by their defaults and thus it would be relatively less risky to lend to them. Nations that default could use the money they get from exporting to finance imports on a cash basis; they would no longer be paying interest. There also would be barter and countertrade arrangements.

Finally, in market economies, contractions of some sectors are eventually compensated for by expansions of other sectors. If trade declines, resources employed in export industries will relocate in industries that produce imported goods and services, or close substitutes for them, and elsewhere. There is an equilibrating mechanism at work, even though it doesn't work instantly or painlessly.

Compromise Is Necessary

An IMF/World Bank "Special Study" (International Investor, Sept. 1982) noted that "the numbers of borrowers tottering on the edge of default or bankruptcy, hence, the amounts involved, is simply staggering. So bankers have been forced increasingly to turn to one device to avoid such calamities: rescheduling."

What it comes down to is this: When debtor nations do not have the money to meet their debt-service obligations, their debts can be rescheduled and their debt-service payments adjusted. Rescheduling is the market's way of dealing with a debt crisis. It produces benefits for both banks and debtors. Banks don't have to write down problem loans. Debtor nations avoid the onus of default. Rescheduling is more attractive to creditors if debtors devalue and take other hard steps to improve their trade and current-account balances and agree to rescheduling fees and to higher-than-market interest rates on rescheduled loans and any new loans. It is more attractive to debtors if banks agree to long stretch-outs of existing loans and extend new credits. The alternative to reaching an agreement is usually dismal for one or both parties.

The IMF can play a constructive role in the rescheduling process. It can mediate differences. It doesn't need to give money to debtors to do this. Indeed, giving money is likely to prevent some necessary rescheduling adjustments, as both debtors and creditors would be less likely to compromise.

Mr. Weintraub is senior economist for the Joint Economic Committee of Congress. This is adapted from his monograph, "International Debt: Crisis and Challenge" (George Mason University).

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"Rather than refuse deposits, the [14th century] Medicis succumbed to the temptation of seeking an outlet for surplus cash in making dangerous loans to princes."

– Raymond de Roover, *The Medici Bank*
(New York: New York University Press, 1948)

The Washington Times FRIDAY, FEBRUARY 18, 1983

PAUL CRAIG ROBERTS

The milking of Uncle Sap

It used to be that Americans could rely on Congress to put American interests first, but no more. Congress is about to raise taxes, reduce Social Security benefits, freeze military pay — and pass an $8.4 billion appropriation for the International Monetary Fund. Uncle Sam doesn't have enough money to meet U.S. needs, but he has an open pocketbook for shoveling out money through an international agency to bail out foreign governments that can't repay their bank loans.

A country that tightens its own belt in order to give away its resources to others ought at least to get credit for it. But with the progressive enfeeblement of American diplomacy, we now turn our largess over the third parties like the IMF to give away for us.

By handling the bailouts through the IMF we cannot extract anything in return, such as naval bases, CIA stations or a favorable word in the United Nations. Even worse, by responding to demands for money we legitimize the chorus of voices that holds the United States responsible for Third World poverty, world recession and the inability of developing countries to repay their loans.

Some large American banks, in over their heads in foreign lending, are finding the Third World's tactic of scapegoating Uncle Sam convenient, and they have put their own spin on the theme. For example, Manufacturers Hanover, the fourth-largest American bank, claims in its January 1983 *Economic Report* that Eastern bloc countries are suddenly unable to service their debt "because of a change in political relations between the United States and Russia," a change "imposed by the United States."

In other words, the way Manufacturers Hanover sees it, President Reagan got tough with the commies, and that put the bank's otherwise sound loans to Eastern Europe on the skids. It is part of the process of making amends for Congress to fork over money for a 50 percent increase in IMF quotas and an enlarged emergency fund known as the General Agreement to Borrow.

The alternative to an IMF bailout is not an international financial collapse. Since almost all of the IMF's resources come from the United States and its allies, the Western alliance could run the bailout on its own — and get something for it.

Passing foreign aid through an international bureaucracy reduces the control and influence of the donor countries. The ultimate result is to divorce foreign aid from the policy interest of the United States and the NATO alliance. When we let the IMF disburse our money for us, we cannot extract political and strategic benefits from the recipient countries on a *quid pro quo* basis.

There is no obvious reason why the United States should use its scarce resources to increase the power of the IMF, a supranational organization that we do not control.

"By handling the bailouts through the IMF we cannot extract anything in return, such as naval bases, CIA stations or a favorable word in the United Nations."

At a time when the Defense Department cannot get $40 million to help Guatemala stay out of communist hands, we should not be transferring $8.4 billion to the IMF, from which it can be disbursed independently of our national security and foreign policy interests.

There are other good reasons for approaching the international debt problem independently of the IMF. The IMF's rapid growth in recent years did not prevent the current crisis, and its further growth does not preclude a future crisis.

For some countries, the cost of servicing their debt exceeds their current and projected export earnings. Such an imbalance implies an eventual partial, if not complete, default. Instead of throwing good money after bad and lending foreigners the money to pay the interest on what they have borrowed already, we should be using our resources to strengthen the ability of our banks to withstand default. For example, banks could be allowed larger tax writeoffs to build up their reserves against bad debts.

Allowing the IMF to run the show actually gets our banks in deeper, because the IMF bailout packages require additional lending by U.S. banks.

The deeper our banks, the State Department, the Treasury Department and the Federal Reserve get involved in trying to prop up old loans with new ones, the greater the stake they acquire in the resurgence of world inflation. Rapidly rising oil and commodity prices would provide the Third World with growing revenues to service a depreciating debt — and the American consumer could be left holding the bag in a big way.

It wasn't that long ago that the United States stood astride the world like a colossus. Our financial and diplomatic power was respected, and countries sought to be in our good graces. We even managed to conduct our diplomacy through our own institutions. But today, after subordinating our interests to international organizations, the United States stands before the world as Uncle Sap. We ante up to quiet foreigners shouting insults while the president's tax cuts and defense buildup fall under the budgetary knife.

The world has serious problems that require U.S. leadership, but the United States cannot lead as long as it acquiesces to demands. We must resist strongly the notion that foreign debtors have our banks over a barrel or they will take advantage of the situation to extract ever more American resources through the IMF.

Paul Craig Roberts, former assistant Treasury secretary for economic policy, holds the William E. Simon chair in political economy at the Center for Strategic and International Studies, Georgetown University.

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Let's Talk Money at Williamsburg

By Lewis E. Lehrman

Williamsburg is an economic summit without an agenda. That shouldn't be surprising, for the West today has no coherent economic order—unless you count austerity and sacrifice.

Recently, I returned from a trip to European capitals. Central-bank officials and ministers of trade did acknowledge the profound problems of monetary disorder, exchange-rate fluctuations and their protectionist effects. Yet, while the French government now calls for a return to the Bretton Woods system—profoundly flawed itself but certainly more effective than the present float—no minister with whom I spoke believed international monetary problems would be formally discussed at Williamsburg. This pessimism about the possibilities of reform is striking, coming only six months after Treasury Secretary Regan called for a monetary conference.

The issue of international monetary reform and the new arguments for different systems of fixed exchange rates arise from the failures of the managed currency float of the past 10 years. During this period, economies of the West declined and protectionism intensified. Ideas of reform originated in the 1960s, with the purpose of curing the primary defect of Bretton Woods—the reserve currency status of the dollar, which led to a permanent balance-of-payments deficit in the U.S. These ideas have not yet been sufficiently considered. Now is the time to do so.

The evidence is compelling that reconsideration of the world monetary system is overdue. One need only review the history of the last few years in America, Britain, Germany and France, as their economies declined under the weight of the monetary and interest rate disorders engendered by central bank money market manipulation.

In Britain in 1979, Margaret Thatcher's Conservatives campaigned against the Keynesian credit policy of the Bank of England and the sterling depreciations of the Labor government. Mrs. Thatcher's campaign called for a stable currency, economic growth, low interest rates and financial order. After nearly four years of austerity and an unapologetically monetarist central banking policy, Britain still has 13% unemployment. Output is no higher than four years ago. Meanwhile, the pound's value fell from $2.50 to $1.45—beneath the lowest level under the Labor. The cost of credit, the touchstone of economic growth, hovers at real rates of 8% to 10%, depending on the quality of the borrower, even as the public-sector borrowing requirement has diminished as a percentage of GNP.

France's Currency Collapsed

In France, Francois Mitterrand's Socialists campaigned in 1981 against the credit and budget austerity of President Giscard. They promised a statist industrial program of economic expansion. However, Mr. Mitterrand's conventional neo-Keynesian policies of government spending and credit expansion led to the collapse of France's currency. The trade deficit grew to $14 billion a year and domestic inflation intensified. Now, the new Mitterrand policy of austerity, designed to deal with the crisis is, of all things, Thatcherite monetary targeting joined to the most draconian inequity of all—wage and price controls aimed at lowering real wages. Despite the stringency of the Mitterrand austerity, interest rates have risen and unemployment is over 9%. He has repudiated the very goals of economic expansion and job growth for which his government was elected.

In Germany in 1982, Helmut Schmidt's Social Democrats also presided over rapidly rising unemployment occasioned by the government-sponsored Bundesbank policy of credit austerity, monetary targeting and high interest rates. By the summer of 1982, Mr. Schmidt's coalition fell apart as his Free Democrat allies, sensing repudiation, switched affiliation to the Christian Democrats. What made Hans Dietrich Genscher and his Free Democrats jump ship was massive defections from the Schmidt economic policy, as measured by opinion polls. Germans of both parties rejected the policies of austerity.

Capitalizing on discontent with austerity, Helmut Kohl's CDU negotiated a deal with the FDP and shrewdly called for early elections in March 1983. They won those elections by a decisive margin, campaigning for a program of economic recovery.

In the U.S., President Reagan came to office in 1980 after a brilliantly successful campaign based on job creation, new investment, stable money, lower interest rates and economic growth. It is true that inflation has come down. And it is true that, unlike most of his Western European counterparts, Mr. Reagan has significantly reduced marginal tax rates. But the real cost of credit for homes and business is still unacceptably high. Industrial production does not yet exceed 1979 levels. There are still over 11 million unemployed.

Only a world currency will work. That is why having national currencies convertible to gold—an international money—has worked in the past and will work again.

The credit policy of Fed Chairman Paul Volcker has brought down inflation while producing one of our greatest recessions, a world banking crisis, and a political setback for the Republicans in November 1982. But the policy of monetary austerity, and the recession it caused, was not President Reagan's program of 1980. It was instead the policy of the Fed and the Office of Management and Budget. Like Mrs. Thatcher, Mr. Reagan unwittingly fell into the trap of his advisers who advocated credit austerity.

And so the West sways between expansionist central bank credit policies that lead to the euphoria of inflation, and austerity policies of credit contraction, which lead to the despair of unemployment and spiritual poverty. In a larger sense, and to some practical extent, this stop-go economics has impoverished us all. European and American workers are punished by Socialists and Conservatives for the "sin" of wanting wages that keep up with inflation.

In the meantime, because of unemployment, Western governments are preoccupied with the balance of trade—an all-time fallacy. The specter of protectionism is on the rise. But our disorders in the world trading system cannot be cured by GATT or by trade agreements. Those disorders are monetary in origin. Protectionism thrives on competitive exchange-rate policies, brought about by the abrupt currency depreciation and appreciations of well-meaning but uncertain central bankers and politicians.

Many central bank officials in Europe speak with pride about the new austerity. They look with equanimity on the 35 million unemployed of the OECD countries. The question is: Must policy makers put 2.5 million people out of work in Germany, 3 million in Britain, 11 million in the U.S.—in order to reduce inflation? Surely those who still believe in the future of the Free World and in the American dream must answer: No, there is a better way. Only national and international monetary reform can cure our monetary disorders.

It was the German monetary reform of 1948, based on a new convertible currency—a deutschemark tied to gold—that along with deregulation produced the German Miracle. It was the creation in 1959 of a convertible gold franc, which brought forth the savings and investment, that made the Fifth Republic of De Gaulle rich enough to create both nuclear defense and national prosperity. The gold convertibility of the dollar, and multilateral convertibility in Europe—the hallmarks of the Bretton Woods system—created the conditions for postwar prosperity. But the Bretton Woods system had the great flaw of being based on the *official* reserve currency status of the dollar.

System Is in Deep Trouble

The monetary order of Bretton Woods was never reformed in this respect. As a result, when the dollar collapsed in 1971, Bretton Woods collapsed too, just as Prof. Jacques Rueff and Robert Triffin forecast in 1959.

There is no major country yet willing to look at the fundamental flaw of the international economic system: the notion of political leaders that national economic and monetary policy can be made independent of the world economy.

The truth is that there is only one economy. It is the integrated world economy. Therefore, national economies need a monetary coordinating mechanism. And that is why an integrated world economy needs a common monetary standard, which is the best neutral international coordinating device. But no national currency will do; only a world currency will work. That is why having national currencies convertible to gold—an international money—has worked in the past and will work again.

Even Mrs. Thatcher was recently quoted as saying, "It's absolutely vital for us to jointly pursue policies which enable us to get and keep interest rates down and to keep inflation down." There *is* such a policy. The policy of convertible currencies, linked to an international monetary standard, is the only one which has worked reasonably well in the past. The policy is imperfect, as are all human institutions; but a system of fixed exchange rates which is the incidental by product of the real international gold standard is the least imperfect of the international monetary systems we know. Without such a free-world monetary order we shall never restore sustained price stability, long-term capital markets at low interest rates, and the investment boom which alone can lead to reasonably full employment.

Without a reformed monetary system of multilateral, unrestricted convertibility of the major Western currencies into gold, we shall continue in a topsy-turvy world, oscillating between autarky and entropy. Incredibly, Socialists will talk of reducing the real wages of workers to increase profits and end trade imbalances, as they do now in France. And self-styled anti-Keynesian Conservatives will rely on neo-Keynesian central bank credit expansion to create economic booms in order to end austerity and get reelected.

The international monetary system is in deep trouble; we won't just muddle along much longer. The time to deal with the so-called "structural" problems of our monetary order is now. If we do, we can once again create conditions of rapid non-inflationary growth. If we don't make the reforms, sooner or later the world economy will founder.

Only the U.S. can take the lead. We must begin at Williamsburg.

Mr. Lehrman, who ran for governor of New York in 1982, is writing a book on economics and monetary policy.

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The Big Bank Bailout of 1983 begins

PATRICK BUCHANAN

Sad to report, but the conservatives have begun signing on to the Great Bank Bailout of 1983.

Sen. Bill Armstrong of Colorado, who chairs a subcommittee on international insititutions, suggests that we have no choice but give the International Monetary Fund the largest national slice of the $50 billion it wants. Big John Connally of Texas, while conceding the folly of the big banks, reluctantly agrees.

Don Regan and Beryl Sprinkel of Treasury trek to Toronto, trepidatious Christians ready to face the lions rather than burn incense at the altar of the IMF, and return to the catacombs, new acolytes of Apollo, telling us we must now all burn incense to the pagan gods and it is not all that bad once you get the hang of it.

President Reagan sends the signal in his State of the Union address: "We will continue to work closely with the International Monetary Fund to ensure it has adequate resources to help bring the world economy back to strong non-inflationary growth."

Look at it this way, Fed chairman Paul Volcker soothes the House Banking Committee. This is not a "bailout" of the big banks; it is a "bail-in," heh-heh, since the big banks are being forced to shell out even more money to their debtor clients to get the IMF aid.

And so they are — with Yugoslavia the textbook case. The U.S. government in the lead, 11 Western nations agreed to give Communist Yugoslavia $1.3 billion in new money, but only if the Western banks provided this insolvent communist regime *another* $1 billion in new loans.

The same situation obtained in the great Mexican bailout. The U.S. government and the IMF poured in billions, but the big banks were also *required* to send new billions chasing the tens of billions already gone.

Can no one see what is going on here?

The ultimate in foreign aid machinery is being created with the consent and complicity of a conservative American government, a machine beyond the erotic imaginings of the Brandt Commission and the Socialist International.

The "New International Economic Order" under which the black and brown nations of the socialist south have a permanent moral claim upon the wealth of the white and capitalist West is being created before our very eyes — Regan & Reagan, Architects.

Not a week passes without some new country declaring it cannot pay its debts, and the IMF rushing to the rescue with Western capital, dragging along the hapless banks. Not a single insolvent regime, no matter how odious, appears to have been denied a seat at the sumptuous banquet table of the IMF — to be forever set by the taxpayers of the United States.

It is not the best of foreign enterprises that are first in line at the loan windows of the IMF. It is the worst — the bankrupts, the freeloaders, the deadbeats, the insolvent, the illiquid, walking away with the capital: Stalinist Romania, $10 billion in the hole; Yugoslavia, $20 billion and bust; Argentina, $40 billion in debt, with wholesale prices rising at a 300 percent rate; Mexico, $80 billion in debt, with foreign earnings collapsing by a billion dollars every time the price of a barrel of oil falls another $2.

If this massive transfer of American capital to the IMF and the Third World is a wise, prudent investment, let us fairly ask: How much of the *personal* wealth of these affluent international bankers is invested in such loans? How much of David Rockefeller's *personal* wealth was sent down to Mexico City — along with the savings of his Chase Manhattan depositors — *after* the threatened August default? How much of Robert McNamara's personal wealth was sunk into the Tanzanian economy along with those hundreds of millions of American dollars he sent off to Julius Nyerere from his upholstered perch at the World Bank?

If the IMF facility and bank bailout — use your own terms — represent wise and prudent investments of our money, why don't the rich and powerful men demanding it put their personal fortunes on the line, alongside the savings of the rest of us? Let us prosper, or sink, together. Right?

Not to worry, the follies of the past will not be repeated, we are assured. This time the IMF will place "conditions" on the loans.

But the folly is being repeated! The only condition that will make Yugoslavia and Romania sensible economic investments is to demand that both junk their ridiculous Marxist economic systems.

Has the IMF done that? The only way Mexico and Tanzania can become prosperous nations is for the former to abandon its socialist nostrums and controls, and the latter to jettison the new-Maoist government by far the worst that has ruined that country. Did the IMF tell them that?

After two years of immense economic hardship, we Americans have accumulated a savings pool upon which all our hopes for recovery depend. Why, when capitalism is desperate for credit, would intelligent capitalists ship their wealth off to subsidize any Communist and socialist failure?

We pay and the LDCs get a blank check

PATRICK BUCHANAN

As President Reagan scrounges about for a piddling $50 million for ammunition for the beleaguered army of El Salvador, the House Banking Committee is greasing the skids for the International Monetary Fund-Bank Bailout, involving a sum a thousand times as large.

The $8.4 billion bundle, the U.S. share of the $47 billion IMF package, is said to be unstoppable. Perhaps so. When, previously, the president lined up with the establishment, the coalition proved invincible.

Eventually, however, when the American people learn how the Republican Party conspired to use their savings — to spare Rockefeller's reputation and save Rockefeller's bank — while less-favored businesses were allowed to perish at the rate of 500 a week, a reckoning will come.

But the point here is not to underscore anew the social injustice or political folly of the Big Bank Bailout, but to limn the Brave New World toward which we now seem irretrievably headed.

With that $47 billion, the IMF will receive more than an immense slice of the accumulated savings of Western people. With it goes unprecedented clout, lethal leverage over the American banks — to a claque of international bureaucrats who bear no allegiance whatsoever to the United States.

What is taking place is not simply a transfer of savings, but a transfer of sovereignty.

Here is how the New International Economic Order — the dream of the Brandt Commission, the demand of the Third World — will work:

One by one, the bankrupts of the Communist Bloc and the Socialist South will be arriving in Washington, D.C., and queueing up at the offices of the IMF.

We cannot pay our debts, they will say; besides, we need more money. Not to worry, the IMF officers will answer. We will draw up an "austerity plan" for your economy. Upon your acceptance, we will tide you over with a few hundred million or billion from our newly replenished hoard of capital. In addition, the Big Banks will be "bailed in" to your rescue plan, i.e., the Big Banks will be required by the IMF to send good American dollars chasing the tens of billions in bad loans. If a country balks at the IMF terms, it gets no new money; if a bank balks at the IMF demands, it gets no relief — i.e., no interest on its old loans.

With the new billions and enhanced power, the IMF will gain permanent access to the investment capital of the United States, a decisive voice in how much of America's savings, henceforth, will be used to maintain the credit ratings of regimes from South America to Central Africa to Eastern Europe. As not a single applicant at the IMF window has yet been turned away, we may expect this record of generosity with our money to continue.

Before our eyes and by the hand of our Congress, the greatest foreign aid machine in history is being constructed, a system of permanent wealth transfers from the capitalist West to the anti-capitalist South and the communist East.

It will work, Don Regan of Treasury assures us, because the IMF "requires debtor nations to pursue sound economic policies." The IMF "is playing a key role in assisting nations to move back to a sound economic footing."

That so? What "sound economic policies" were imposed by the IMF upon Stalinist Romania, $10 billion in debt, as a condition of its latest loans? Has Mexico, beneficiary of the biggest bailout, been placed upon a "sound economic footing" when President de la Madrid continues to hold that 75 percent of the private economy was seized by Lopez Portillo and the thieves so lately departed?

The rules of economics and sound banking are being stood on their heads.

Do you truly help people mired in poverty by collaborating with the socialist regime responsible for their condition in imposing "austerity" upon them? Do you truly help countries hopelessly in debt by increasing that debt? Do you truly assist banks with billions in bad loans by increasing their exposure to bankrupt regimes? Can the way into this mess be the way out?

Who is looking out for the American people? One day, they will demand to know why their savings were plundered to be shipped off to Nigeria and Mexico and Venezuela so these three arrogant oil producers could hold production down and keep prices up, the better to gouge the very American people bailing them out.

Watching Mr. Conservative march merrily toward this sunken road calls to mind the *cri de coeur* of Oliver Cromwell in his letter to the Church of Scotland: "I beseech you, in the bowels of Christ, think it possible you may be mistaken."

The Big Bank bailout

Congress is now well into the process of passing a piece of legislation known as the "IMF quota bill." A more honest title would be the "Taxpayer-Assisted Capital Export, Interest Rate Increase and International Bank Rescue Act of 1983."

Over the past decade the West's largest banks had lots of money, much of it from OPEC deposits in their overseas branches. So the banks blithely lent a quarter-of-a-trillion dollars to communist and Third World countries like Poland, Romania, Sudan and Zimbabwe. The interest rates and front end rates made such loans very, very profitable.

The big banks assumed that governments would not default; or if they did, the International Monetary Fund would come to the rescue; or if not that, the U.S. Federal Reserve would print some new money and spread it around.

Many of the borrower countries used much of the money — that is, what was left after the usual graft and corruption — not to improve their economic productivity, but to buy and consume oil and food. And most of them continued the unsound and corrupt economic practices that got them into trouble in the first place.

Now the loans are coming due, and many of the borrowers can't pay. The loans are thus "rescheduled." Meanwhile, the big banks are trying to get somebody else to cover their losses. One way or another, they have you in mind.

The IMF quota bill will allow your government to exchange 8.4 billion U.S. dollars for a claim on a supposedly equivalent amount of foreign currencies. The IMF then will lend the dollars to the deadbeat borrowers. The big banks then will lend yet more money — sucked away from small business, farmers, local banks and home buyers here in America — to allow the Zimbabwes of the world to pay the interest on their delinquent loans. And thus ever more layers will be added to this tottering house of cards.

All the while our Treasury and the big banks are siphoning dollars from our own economy — and thus putting upward pressure on interest rates — the IMF is sitting on 103 million ounces of gold, worth some $43 billion at current prices. If the IMF thinks it needs more cash to protect the big banks and the bad borrowers, why doesn't it hock its gold to raise the money? The answer is that the IMF would rather extract more capital from Americans than sell its family jewels.

The backers of this scheme are quick to say that this is not a "bank bailout" — because instead of getting repaid from IMF loans, the banks are actually pouring more money into those bad credit risks. The fact is that the big banks have only one choice to make. They can write down the bad loans. But that would make the nation's nine largest banks technically insolvent, so that's not very attractive to them. The alternative is to pour ever more money into bad loans, push through the IMF bill, and keep working on other even more obscure schemes for shifting the risk from themselves to the American taxpayer.

All along these same big banks have rolled up record profits from high fees and interest rates on loans which eventually will default. The same banks profited from big loans to Panama a decade ago, and were forced to lobby for ratification of the 1978 Panama Canal Treaty to allow Panama to get its hands on enough new revenues to service their loans. The same banks profited from big loans to the Shah of Iran, and then had to take over the Carter administration's foreign policy to get their money back. The same banks lent billions to the tyrannical regime in Poland, over the protests of Solidarity and our own AFL-CIO, and then persuaded our government to buy out their bad loans without an embarrassing declaration of default.

For a long time, some of our big banks have profited from irresponsible and even immoral lending practices. And every time when the piper must be paid, they have tried to send the bill to the small businessman, farmer, homebuyer and taxpayer. Enough is enough. Let them pay for their own mistakes.

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Introduction — *continued from page 5*

5) IMF conditions are mostly lip service; once the IMF has started to lend to a country, it finds it very difficult to cut that country off for failure to meet conditions. It merely overlooks non-compliance or relaxes the conditions, and keeps on lending.

6) IMF lending is propping up socialist and communist regimes and human rights violators, countries like Viet Nam, Kampuchea, El Salvador, South Africa, Guatemala, Grenada, Romania and Iran. American dollars should not be used for this purpose; economics cannot be divorced from morality.

7) The IMF subscription reduces U.S. jobs, since the export industries which benefit are usually more capital intensive than non-export industries.

8) IMF conditions penalize our exporters, because one condition is almost invariably the encouragement of borrower country exports (which compete with U.S. exports elsewhere) and the limitations of imports (which diminishes the market for U.S. products.)

9) Extracting another $8.4 billion from the U.S. economy, regardless of the budgetary sleight of hand used to avoid a deficit impact, will heighten competition for capital and thus exert an upward pressure on domestic interest rates.

10) The price of the IMF rescue operation appears to be vastly strengthened government regulation of banks, including the creation of new reserves which constitute a tax on bank lending.

11) There is no longer a proper role for the IMF as a lender, since the day of fixed exchange rates seems to be over. It continues in this role only because its bureaucrats refuse to relinquish their power, and because the banks are eager to see government dollars injected into their debtors.

12) The IMF is sitting on 103 million ounces of gold, worth about $43 billion at current prices. This gold hoard is unencumbered, and could thus easily be used to meet what the IMF claims are present world needs. But the IMF doesn't want to use its gold because it would prefer to accept more dollars — in part because it wants to protect its $1.1 billion 1982 loan to South Africa, the viability of which is tied to a strong gold price.

13) The IMF has a contradictory role as both a lender and a credit bureau. It should abandon the former and concentrate on the latter.

14) The IMF has long since lost sight of the impact of the policies it imposes on the working people and peasants in debtor countries. It has often become an engine of oppression instead of a force for progress.

15) In any case, the problem is manageable without another round of lending. Some of the largest banks would experience losses and embarrassments, but they would survive and so would the economy.

These arguments, which interestingly come from a number of different ideological and political points of view, constitute a serious challenge to the Administration's case for the IMF quota increase. It may well stimulate a long overdue debate on the broader questions of an international monetary regime based on something more than "funny money" and sick economies; the need for truly constructive LDC development policies which actually benefit the common man and woman; and the influence over our own government of large, powerful banking interests perpetually seeking to earn big profits in good times while shedding risks to the taxpayer when things go sour.

PENDING INTERNATIONAL BANKING LEGISLATION (JUNE 1983)

On March 2, 1983 President Reagan transmitted draft legislation to Congress to increase the U.S. quota for the International Monetary Fund by $8.4 million. The legislation was introduced by request by Sen. Charles Percy (R.-Ill.) on March 7 as S. 695. In the House the bill was introduced as H.R. 1907.

On March 24 the Senate Foreign Relations Committee issued a favorable report on S. 695 (Senate Report 98-35), with a dissenting view by Sen. Jesse Helms (R-N.C.).

The bill was then referred to the Senate Banking, Housing and Urban Affairs Committee, from which it was ordered reported (with amendments) on April 28.

In the House, Chairman Fernand St. Germain (D-R.I.) of the House Banking, Finance and Urban Affairs Committee introduced a new version of H.R. 1907 as H.R. 2930 on May 5. On May 9 his Committee amended H.R. 2930 and ordered it reported. On May 10 Rep. St. Germain introduced a clean omnibus bill, H.R. 2957, which contains the amended language of H.R. 2930 as Titles II, III, and IV. Title I of the bill contains Export-Import Bank amendments, and Title V contains Multilateral Development Bank amendments.

Senate action is expected in mid-June. Chairman St. Germain has said that the House bill will not be brought to the floor until after disposition of major housing legislation. This could be as early as mid-June or much later in the summer.

For an update on the status of legislation in the Senate, contact the clerk of the Senate Banking, Housing and Urban Affairs Committee (202-224-7391). In the House, contact the clerk of the House Banking, Finance and Urban Affairs Committee (202-225-4247).

Hearings were held on the subject of the world debt crisis before the Subcommittee on International Economic Policy of the Senate Foreign Relations Committee in late January, 1983. Hearings were also held before the Subcommittee on International Trade, Investment and Monetary Policy of the House Banking, Finance and Urban Affairs Committee in late April and early May, 1983. As of May 25, these hearings volumes had not been published. Copies of the hearings may be requested by writing the respective committees (Senate: Room SD427, Washington, DC 20510; House: Room 2129 RHOB, Washington, DC 20515.)

Deja Vu (1932)—

As American credit was loaned to European nations in amounts rising to more than a billion a year, in the general name of expanding our foreign trade, the question was sometimes asked, "Where is the profit in trade for the sake of which you must lend your customers the money to buy your goods?"

The answer was: "But unless we lend them the money to buy our goods they cannot buy them at all. Then what should we do with our surplus?"

Garet Garrett, "A Bubble that Broke the World" published in 1932, in which the author describes American bank lending abroad after World War I. (Republished as Cato Institute Paper #13, 1980)

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THE WALL STREET JOURNAL April 25, 1983

Letters to the Editor

The IMF: The Crutch That Cripples

The International Monetary Fund, in bailing out Guatemala, is promoting disaster.

Why does Guatemala need a loan from the IMF? Because at the current undervalued local (official) price of the dollar, it has become unprofitable (at the margin) to produce dollars (exports) and very profitable to spend the bargain dollars when and if they are officially available. In the black market, dollars command a 35% premium.

In the meantime, the increasingly unprofitable capital investment in export producing crops or manufactures is being neglected when not abandoned. Cotton plantings, for instance, a very large provider of urgently needed jobs, foreign exchange and taxes, will be about 20% of what they would be with a realistic exchange rate.

Ironically, the IMF bailout will temporarily improve our credit-worthiness image and allow us to go further into debt with other lenders as well. In reality, it will reduce our credit-worthiness by increasing our foreign debt, but more so by decreasing our foreign exchange earning capacity, not only now but in the future, because the capital and know-how up to now invested in export producing activities will wander to greener pastures.

By allowing Guatemala to avoid temporarily the needed exchange rate correction, the yield to investment in industrial production for export or import substitution will also continue to deteriorate, thus aggravating the problems derived from the already high unemployment, and fanning political unrest for the benefit of the guerrillas.

And finally, the bailout will permit further decrease in government revenue and more deficit financing, with its accompanying detrimental effects. We'll be on our merry way to join the club of heavily indebted countries while we destroy our productive structure.

The bailout is even more regrettable because it comes at a time when the government of Guatemala is not all of one mind. There are sincere disagreements about the proper course. The IMF's loan tilts the balance in favor of the faction that opposes free exchange and wants to maintain the overvalued exchange rate, the exchange controls, import quotas, travel restrictions, etc., and against those who want to free the exchange. Thus, it will exacerbate our difficulties when we are on the verge of correcting them.

If the IMF didn't exist, our country would be ready to face reality. We would not postpone correcting our wayward ways, and soon would be off to a promising future.

MANUEL F. AYAU
President
Universidad Francisco Marroquin
Guatemala City

MEDIA CONTACTS

The following individuals are available to the media for expert commentary on the world debt issue:

Stephen Hayes
Office of Public Affairs
Treasury Department (Room 2315)
Washington, DC 20220
(202) 566-2041
(To arrange interviews with Treasury officials)

Dr. Paul Craig Roberts
Center for Strategic and International Studies
Georgetown University
1800 K Street, NW
Washington, DC 20006
(202) 775-3292
(former Assistant Secretary of the Treasury)

Dr. Robert Weintraub
Senior Economist
Joint Economic Committee, SDG01
Washington, DC 20510
(202) 224-0374

Lewis Lehrman
641 Lexington Ave.
New York, NY 10022
(212) 759-8534
(Chairman, Lehrman Institute and candidate for Governor of New York, 1982)

Prof. William J. Quirk
School of Law, University of South Carolina
1717 Devine Street
Columbia, SC 29201
(803) 799-6075

Dr. Sudha Shenoy
Cato Institute
224 2nd Street, SE
Washington, DC 20003
(202) 546-0200
(Professor of Economics, University of Newcastle, Australia)

Mark Hulbert
Hulbert Financial Digest
409 First Street, SE
Washington, DC 20003
(202) 546-2164

Fred Smith
Council for a Competitive Economy
410 First Street, SE
Washington, DC 20003
(202) 544-3786

Anita Anand
Methodist Board of Church and Society
100 Maryland Avenue, NE
Washington, DC 20002
(202) 488-5647

Jack Blum
Blum and Nash
1015 18th Street, NW
Washington, DC 20036
(202) 857-0220
(former Senate Foreign Relations Staff)

Dr. Karin Lissakers
Senior Associate
Carnegie Endowment for International Peace
11 Dupont Circle, NW
Washington, DC 20036
(202) 797-6400

Ben Crain, Staff Director
Subcommittee on International Trade, Investment and Monetary Policy
House Committee on Banking, Finance, and Urban Affairs
Rayburn House Office Building
Washington, DC 20515
(202) 225-1271

Dr. Timothy Hallinan
6323 Beachway Drive
Falls Church, VA 22044
(703) 998-7181
(former IMF economist)

George Champion
1211 Avenue of the America
New York, N.Y. 10036
(212) 730-3833
(retired Chairman, Chase Manhattan Bank)

William E. Simon
Westray Corporation
Morristown, NJ
(201) 540-9020
(former Secretary of the Treasury)