# The International Monetary Fund

by Ken S. Ewert

It was on July 1, 1944, just three weeks after the Allies had landed in Normandy, that the most significant intergovernmental conference of the century began. The conference took place at Bretton Woods, New Hampshire, and it represented, in the main, the thinking of two individuals, Harry Dexter White and John Maynard Keynes. Both of these men had grave doubts about the beneficence of market processes and preferred to put their faith in the ability of national and international "managers" to coordinate the world's economic affairs. And in 1944 White and Keynes were not alone in their views. As some 45 countries met to plan out the "new economic order," there was consensus on the necessity for increased economic coordination and a general view that the international gold standard was undesirable because of the restraints it placed on a nation's ability to pursue the "full employment" policies prescribed by the *nouveau* Keynesian wisdom.[1]

Two of the organizations formed at Bretton Woods have become increasingly more important in the world's economic affairs. These are the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (World Bank). Of these two institutions, the World Bank has evoked considerable criticism over the years for its policy of lending primarily to governments instead of to private, profit-seeking organizations. A strong case can be made that the policies of the World Bank have supported world-wide statist economic policies, and discouraged the expansion of the free market. The IMF, however, has generally been more acceptable to defenders of the market, since its operations do not so clearly subsidize anti-free market policies. However, as a closer look shows, the IMF has also been a major influence for statist economic policies.

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The IMF was established "to promote international monetary cooperation" by maintaining fixed exchange rates among the currencies of different nations.[2] To accomplish this, the Fund was to make short-term loans to nations which had temporary balance of payments deficits (i.e., the net imports of the country exceeded its net exports). The short-term loans (usually three to five years) would presumably allow a nation to recover from its imbalance without having to resort to devaluing its currency.

IMF loans were, and are today, made according to the "quota" of each member nation. The quotas consist of the capital each country has paid in, usually 25 percent in gold and the rest in the member nation's currency. A member nation can exchange a portion of its quota to buy another nation's currency (usually dollars, German marks, or Japanese yen). These funds in turn can be used to support the borrowing country's currency on exchange markets or to pay off creditors while it (supposedly) gets its economic house in order.

While the capital for these loans is officially provided by all member nations, in reality it is the industrialized "hard currency" countries who provide the lion's share. At Bretton Woods, nearly every weak currency nation sought to increase its "quota" so that it could "buy" more currencies of real value. The same is true today as many debtor governments favor large increases in quotas while industrialized nations seek more moderate increases. The quota system amounts to an agreement of hard-currency countries to lend funds to the soft-currency countries, and it ultimately represents a net transfer of funds from citizens of industrialized countries to the debtor-nation governments (since the loaned funds are continuously rolled over or re-loaned, and not repaid to the donor country).[3]

Subject to special Fund approval, a member nation can also borrow amounts well beyond its quota. The size and number of these loans (called "standby agreements") have increased over the years, and they usually include specific economic conditions which the debtor nation must observe. The standby agreements usually are repaid over a period of three to five years. In addition to this regular financing, the IMF has greatly expanded its role by establishing several "special facilities" which give the Fund more discretion in lending and allow longer-term loans and larger subsidies for less developed countries (LDCs) which are the principal users of Fund resources.[4]

The Fund's credit-dispensing ability was further expanded in 1970 with the creation of "Special Drawing Rights" (SDRs). While dubbed "paper gold," the SDRs are actually fiat money, i.e., only bookkeeping entries in the Fund's books. They are allocated to countries according to their quotas, and they are used by member nations in their transactions with each other and as reserve assets. The SDR is the fulfillment of what John Maynard Keynes had envisioned in the early 1940s. Keynes proposed a world reserve currency called the "bancor" which supposedly would free all governments from the disciplines of gold. Like the proposed bancor, the SDRs are designed to replace gold in world monetary transactions and to further free member governments to inflate their currencies.

Initially the IMF's primary role was to foster the fixed exchange system.[5] But the Fund had little success at this, since the inflation* in many countries made devaluation of their currencies inevitable.[6] Even the widespread use of IMF credits couldn't sustain the value of debased currencies for long. By the time the fixed exchange system collapsed on August 15, 1971, the IMF had sanctioned more than 200 devaluations.[7]

Not only was the IMF powerless to stop the devaluations, its funding may well have been a net negative force since it restrained and slowed what would have been the normal market corrections of international exchange rates.[8]

When the fixed rate system finally collapsed (as the U.S. abandoned the gold-exchange standard) there were many people who speculated that the IMF would slowly fade into oblivion, since its primary role—maintenance of fixed rates—was eliminated. Such was not to be the case however, and the IMF has survived and even substantially expanded its role in the subsequent years.

When the IMF no longer had fixed exchange rates to justify its existence, it turned to lending for "temporary" balance of payments deficits as its primary function in the 1970s.[9] Between 1970 and 1975 the volume of the Fund's lending more than doubled in real terms, and from 1975 to 1982 it increased by a further 58 percent.[10]

## Balance of Payments Deficits

For the most part, the balance-of-payment lending by the IMF seems to assume that a country's imbalance of payments is caused by factors other than its own economic policies. Examples of externally caused temporary trade imbalances (supposedly proving the necessity of the Fund's role) might be a poor year for a country's major export crop, or a sharp rise in the price of a principal import (such as oil). While national trade imbalances are sometimes caused by such factors, most often the culprit is not some twist of fate but rather the economic policies of the debtor nation's government.

Governments the world over find it expedient to spend more than their citizens are willing to

* The word "inflation" is used here to denote the expansion of the money and credit supply of a nation, not the most noticeable result of that monetary expansion, which is rising prices.

provide in tax revenues. The additional spending is often financed by increasing the quantity of money and credit, which results in rising domestic prices. Faced with rising prices at home, the country's citizens will tend to buy more goods and services from abroad, since they have become relatively cheaper. At the same time, exports from the inflating country will tend to become less attractive to foreign buyers because of their increased cost. The end result is a balance of payments deficit.

This deficit would tend to correct itself if exchange rates were left unmanipulated by the inflating country's central bank. The value of the inflated currency would tend to drop in relation to foreign currencies, and this in turn would discourage imports and encourage exports. But what often happens is that the inflating country's central bank intervenes in foreign exchange markets to prevent the value of its currency from falling to (or closer to) its market level. It can do so, however, only as long as it has access to foreign currency reserves with which it can intervene to purchase its own currency.

## The Results of IMF Rescues

Often when a country has depleted its reserves, the IMF enters and offers loans which enable the inflating government to continue its folly by providing it with the funds to negate (temporarily) some of the consequences of the inflation. According to Henry Hazlitt: "If nations with 'balance-of-payments' problems did not have a quasi-charitable world government institution to fall back on and were obliged to resort to prudently managed private banks, domestic or foreign, to bail them out, they would be forced to make drastic reforms in their policies to obtain such loans. As it is, the IMF, in effect, encourages them to continue their socialist and inflationist course."[11] The IMF thus facilitates inflationary policies (euphemistically called "full-employment policies") in member nations by being a "safety net"—it is always there to bail out its profligate members with fresh funds.

There is no doubt that by rescuing LDC governments, the IMF has helped make possible the massive monetary inflation which has occurred and is still occurring in many of these countries. Even more important, it has allowed governments the world over to expropriate the wealth of their citizens more efficiently (through the hidden tax of inflation) while at the same time aggrandizing their own power. There is little doubt that the IMF is an influence for world-wide socialism.

Although IMF loans have been primarily short term and for the stated purpose of rectifying temporary balance of payments deficits, the Fund has been a *de facto* supplier of long-term financing to many LDCs.[12] A long-term loan is no different from a number of short-term loans strung together, and many of the IMF's member nations have a long record of back-to-back loans.[13] Between 1954 and 1984, 24 member nations used Fund credit for 11 continuous years or longer; it seems that the majority of countries which begin using IMF funds continue to do so.[14]

Without question, IMF lending has had a sizable impact on the long-term economic policies of some LDC governments, and it thus deserves some of the blame for the triple-digit inflation, price controls, oppressive taxation, stifling regulations, and general disregard for private property rights which are common to many of these countries. There is, of course, no way to know what political and economic changes for the better would have occurred in the absence of IMF bailouts, but as *The Economist* notes, the Fund often "stands as the last defense between a mismanaged economy and outright financial collapse."[15] Such a collapse, if it brings an end to statist policies, might well usher in increased economic freedom for millions of people.

## Subsidizing LDC Governments

It might be objected that Fund lending merely takes the place of what otherwise would be private lending to LDC governments. And if this were the case, the IMF could not be held responsible for the policies that these loans made possible. However, the IMF often lends to financial "basket-case" countries which have little hope of obtaining private loans without IMF help. More important, almost all IMF loans are not market-rate loans, but are subsidized, sometimes heavily.[16] Given the basic economic axiom that more of an economic good will be consumed if its cost is lowered, the subsidized loans made by the IMF have encouraged LDC indebtedness and, since such loans are made to governments and not private individuals, increased the politicization of these societies.

Member nations can borrow from ordinary (non-facility) Fund resources at well below market rates. For example, from May 1982 through April 1984, the annual charge for use of these Fund resources was 6.6 percent. During this same period, interest rates paid by LDCs to commercial lenders were between 11 and 13 percent (often plus additional charges).[17]

The bulk of member borrowing, however, is done through Fund "facilities." As of 1984, more than one-third of these loans were financed by Fund borrowings from industrialized governments (rather than from quota contributions). Since the Fund can borrow at substantially lower interest rates than those available to the poor-risk LDC, it implicitly subsidized the borrowing country by passing on this lower rate. Moreover, some of the facilities are even more explicitly subsidized. The oil facility, for example, includes a "grant" factor of some thirty percent.[18]

With the increasing debt burden of many LDCs and the ensuing "international debt crisis," the IMF has garnered even more power and resources. In 1983 the Fund's resources were increased from 61 billion SDRs to 90 billion SDRs, and a number of new lending programs subsequently have been initiated.[19]

In addition to expanding its role as a lender, since the early 1980s the Fund has become the central player in "managing" the debt restructuring packages among debtor nations and their creditors. The IMF coordinates rescheduling packages in which commercial banks, governments of industrialized nations, and international agencies agree to supply new loans and reschedule old loans on the basis that the debtor nation promises to abide by IMF conditions.

The fact that the IMF loans are "conditionality agreements," which require the debtor nations to adhere to (or at least work toward) specific IMF-mandated policies, is pointed to by some Fund supporters as a crucial function served by the Fund, and one which justifies its existence. The Fund is supposedly needed to impose some sort of economic discipline on nations which seem unable to impose it on themselves.

However, the conditions imposed by the Fund are seldom free-market oriented. The Fund concentrates on "macro-policies," such as fiscal and monetary policies or exchange rates, and pays little attention to fundamental issues like private property rights and freedom of enterprise.[20] Implicit in the Fund's stated policy of "neutrality" with regard to national political decisions is a belief that with proper "macro-management" any economic system is viable, whether it be socialist or capitalist. Because the Fund does not advocate the true prerequisite for economic prosperity—a lawfully constrained government which respects private property—its record as an economic manager is rather poor. There is every reason to believe that in the absence of the IMF, private lenders would require conditions (in return for further loans) which would be at least as effective in promoting economic health for the LDC.[21]

Until recently the IMF conditions routinely required "austerity measures" in the debtor nation. These measures often included reduced budget deficits, slower money creation, and more realistic exchange rates. These conditions have invoked widespread protests both from within the "Third World" and from the universities, think tanks, and charities of the industrialized countries. Austerity measures are attacked by liberal critics as being overly harsh, politically unfeasible, and particularly harmful for the poor who depend upon government programs in the affected LDCs.

In response to this criticism, the IMF's newest director, Michael Camdessus, has indicated that the IMF in the future will be less stringent with the debtor nations and place more emphasis on "growth." According to Camdessus, the IMF must take care to "respect a member government's judgment of priorities and of domestic political constraints." Reflecting the same tone, at the annual meeting in September 1987, the IMF interim committee proposed that the "conditionality" of Fund loans should be reviewed in light of the "increased emphasis being placed on growth-oriented adjustment."

In addition to more lenient conditions, Camdessus, with the support of U.S. Treasury Secretary James Baker, advocated more funding (from industrialized countries) for the IMF over the next few years to enable the debtors to "grow" their way out of debt.[22]

The IMF role in the current crisis has not necessarily been beneficial and might well prove, in hindsight, to have worsened the debt situation. As IMF historian Margaret Garritsen de Vries notes, IMF involvement has prompted "net new lending from commercial banks on a much larger scale than had been thought possible in mid-1982."[23] Presumably the commercial lenders have been willing to extend new funds for one of two reasons: either they believe the IMF will "straighten out" the debtor nation's economy, or they believe that the IMF's involvement in the rescheduling process is an implicit guarantee of these loans. Congressman Henry B. Gonzalez, among others, believes the latter is true, and has called the IMF an "international FDIC for banks."[24]

Whatever reason for increased lending, if, as seems likely, the LDC debtor nations fail to "grow" out of their present predicament, the IMF deserves much of the blame for the future losses and financial havoc which will result.

There are indications that the Fund may be currently evolving beyond its debt management role. It is clear from recent statements by Fund Director Camdessus that the IMF desires a more central role in international economic policy coordination and management of exchange rates. In fact, in recent years the IMF's annual meeting has increasingly come to serve as a focal point for the major industrialized countries' finance ministers and heads of central banks to meet and discuss economic coordination.

However, until now the U.S. has sat "in the driver's seat" so to speak, because of the premier position enjoyed by the dollar among world currencies. The IMF, supported by several industrialized countries, advocates replacing the current American pre-eminence in the global economic management process with the international oversight provided by the Fund. In order to achieve this, Director Camdessus advocates that the dollar be replaced as the world's reserve currency by the IMF-issued SDRs.

## Conclusion

The IMF is seen by many within government (as well as banking and academic) circles as "the world's master economic trouble-shooter," and there is a growing call for an increased role for the Fund in world monetary and economic affairs.[25] More than 40 years after the Bretton Woods Conference, the same call continues to be echoed: "We need more international economic coordination."

Yet the faith that governments around the world are ever willing to place in a supranational organization like the IMF seems ill-founded. After all, the IMF has failed to achieve its original goal of maintaining fixed exchange rates, it has failed to attain its subsequent goal of improving the balance of payments problems of LDCs, and it is currently failing to solve the world debt crisis. Moreover, its "successes" also are open to serious question. It has financed statist policies in LDCs, it has transferred billions of dollars from citizens of industrialized nations to Third World regimes—some of them despotic—and it has facilitated worldwide inflation.

Why, then, the widespread support for the IMF?[26] The reason is more straightforward than many of us would like to believe. When governments speak of the need for "increased economic coordination," what they mean is that governments around the world want to better synchronize their inflationary monetary policies. Inflation is politically expedient for every government in our age. It temporarily stimulates economic activity and in so doing buys considerable political favor. Only later when the unpleasant effects appear—rising prices, economic dis-coordination, consumed capital, and unemployment—does the inflation become a political liability. The illusive goal pursued by governments around the world is to reap the political benefits of inflation without paying its subsequent costs.

The IMF is seen as a means to achieve this goal of simultaneous world monetary expansion. As Hans F. Sennholz observes, the IMF represents the "spurious notion that the policy of inflation can be made to last indefinitely through cooperation of all member governments. It acts like a governmental cooperative with 146 members that tries to coordinate the inflationary policies of its members."[27] It is this vain pursuit that has sustained and nurtured the IMF throughout its history. □

1. The Treasury Secretary at the time, Henry Morgenthau, declared: "It has been proved . . . that people in the international banking business cannot run successfully foreign exchange markets. It is up to the Governments to do it. We propose to do this if and when the legislative bodies approve Bretton Woods." Cited in Henry Hazlitt, *From Bretton Woods to World Inflation: A Study of Causes and Consequences* (Chicago: Regnery Gateway, 1984), p. 88.

2. Article I of the original "Articles of Agreement," cited in Margaret Garritsen de Vries, *The IMF in a Changing World: 1945-1985* (Washington: The International Monetary Fund, 1986), p. 14.

3. According to Henry Hazlitt: "The guiding idea of the conference, even at its opening, was that the value of the weak currencies should be maintained by the countries with strong currencies agreeing to buy them at a fixed rate, regardless of their market value." See Hazlitt, p. 46.

4. These "special facilities" include: 1) The General Arrangements to Borrow which coordinates the lending of ten major industrial countries to wayward debtor countries in order "to forestall or cope with an impairment of the international monetary system." 2) The Compensatory Financing Facility which allows short-term, non-conditional loans to countries suffering from a temporary major decline in primary exports. 3) The Oil Facility and Subsidy which was established in response to the sharp increase in oil prices and allows minimal-condition loans beyond normal drawing rights. 4) The Extended Fund Facility which was established in 1974 to allow longer-term financing (over 8 to 10 years instead of the previous 3 to 5 year terms for repayment). With this special facility, the Fund has officially moved into the medium to long-term financing traditionally done by the World Bank. 5) The Supplementary Financing Facility, which was financed by Fund borrowing from industrialized country governments, further aided countries which had large payments deficits and did not qualify for regular IMF financing. See Richard Goode, *Economic Assistance to Developing Countries Through the IMF* (Washington: The Brookings Institution, 1985), pp. 5-10.

5. More accurately, a system of "adjustable peg" rates. It was recognized that occasionally "fundamental disequilibriums" would occur in a nation's balance of payments which would necessitate adjustments in the value of the currency.

6. "Currency depreciation can always be avoided through a sufficiently restrictive, usually disinflationary, monetary policy. Exchange crises are—from a technical point of view—always the fault of the country's own monetary authorities." Roland Vaubel, "The Moral Hazard of IMF Lending," in Allan H. Meltzer, ed., *International Lending and the IMF: A Conference in Memory of Wilson E. Schmidt* (Washington: The Heritage Foundation, 1983) pp. 69-70.

7. Hans F. Sennholz, *Age of Inflation* (Belmont, Mass.: Western Islands, 1979), p. 138.

8. Without IMF assistance, "the countries with the most inflation would have suffered the consequences of their currency debasements much earlier and would have had to retrench much sooner." Sennholz, p. 138.

9. As *The Economist* wrote on January 17, 1976, "the IMF did its best to resist the change to floating. Now that it has had to be accepted, why is the IMF still bent on credit creation?" (cited in Vaubel, p. 70).

10. Vaubel, p. 66.

11. Hazlitt, p. 14. Even if the balance of payments problem were due to a "temporary" shock such as a sharp increase in the cost of oil imports, there is no reason to believe that postponing the necessary adjustment by borrowing will be beneficial to the country. Even if such "adjustment smoothing" was advantageous, the country hit by the disturbance could borrow in the international capital markets. This would lead to a better utilization of resources because the borrower would pay the full cost, instead of using subsidized IMF funds. The borrower "would have to borrow at the opportunity cost of lending in the rest of the world." (Vaubel, p. 71).

12. In recent years, the IMF has been increasingly lending for longer periods, often ten years.

13. "The IMF appears to have created a class of permanent bad-credit nations that have grown accustomed to its emergency assistance." Fred L. Smith, Jr., "The Politics of IMF Lending," *Cato Journal*, Vol. 4, No. 1 (Spring/Summer 1984), p. 222.

14. Goode, pp. 19-20.

15. "Poor Man's Fund," *The Economist*, February 13, 1988, p. 14.

16. Vaubel, p. 66.

17. Goode, pp. 15-16.

18. Goode, p. 18.

19. The Structural Adjustment Facility (SAF) was established in 1986 in order to aid the poorest African, Asian, and Pacific countries. It allows the borrower a five-year grace period after which repayments begin and continue for another five-year period. IMF Director Camdessus is seeking an expansion of SAF from its current three billion SDR to 11 billion SDR. In the fall of 1987, Treasury Secretary James Baker proposed yet another IMF facility called the External Contingency Facility which would provide further aid to help sovereign debtor and creditor countries. (Anthony Rowley, "All Friends Again: IMF-World Bank Meeting Produces Harmony, If No Answers," *Far Eastern Economic Review*, October 15, 1987, pp. 67-70).

20. "Does it make any difference whether budgets are balanced by cutting spending or raising taxes?" I [Tom Bethell] asked the IMF information officer.

"That's a national political decision," he said. "How the government does it is its own affair."

I raised the problem of very high tax rates in many Third World countries.

"What is too high?" he asked.

"What about property rights?" I further inquired. "Do you insist that they be respected?"

"No," he said. (Tom Bethell, "Loony Lending," *National Review*, October 14, 1983, p. 1260).

21. The lenders could, in the absence of the IMF, form a type of consortium arrangement for dealing with their problem debtors. Moreover, IMF programs have not been very successful in curing these sick debtors. A former executive director of the Fund, Jahangir Amuzegar, admits ". . . it is disturbing that, despite its valiant rescue efforts across the Third World, the IMF is hard pressed to show more than a few clearly viable programs out of the roughly three dozen under its wing." (Jahangir Amuzegar, "The IMF Under Fire," *Foreign Policy*, Fall 1986, p. 114) Another author notes that "According to an analysis performed by T. R. Reichman, an economist in the Fund's powerful Trade and Exchange Relations Department, 21 stabilization programs initiated after Oil Shock I had only about a 33 percent success rate." Michael Moffit, *The World's Money: International Banking from Bretton Woods to the Brink of Insolvency* (New York: Simon and Schuster, 1983), p. 130.

22. Rowley, p. 70. IMF Director Camdessus is presently calling for a further doubling of the Fund's capital.

23. de Vries, p. 189.

24. Smith, p. 218.

25. Amuzegar, p. 98.

26. There is also, happily, growing opposition to the IMF. The debate over increased funding in 1983 prompted a powerful coalition of Left/Right IMF opponents including Ralph Nader and Howard Phillips. It was only the about-face switch of the Reagan administration, which had been very critical of the IMF until the fall of 1982, that assured passage of the funding increase. Treasury Secretary Donald Regan was quoted in the *Financial Times* as saying, "I lobbied 400 out of 435 congressmen before that vote." (Smith, p. 238).

27. Hans F. Sennholz, "The World Debt Crisis," *The Freeman*, February 1983, p. 79.

# State Funding Threatens Community Groups

by Robert J. Schimenz

Your local Little League may be on the dole. And it is not alone. Other youth baseball, football, and soccer leagues, police athletic clubs, senior citizen groups, and similar community-based volunteer organizations are on the receiving end of "member items"—state budget items in which elected officials are allotted funds to dole out to community organizations in their districts.

Community groups tend to have tight budgets, and their leaders are usually very frugal with their organizations' funds. The appeal of the state offering thousands of dollars, for the completion of a few simple forms, has been too much for most groups to resist.

If you question the legitimacy of state funding, you will likely hear one of two answers. The first response, typically from an organization member who senses something is askew, is that the money has already been allotted, and some group is going to get it anyway.

This response ignores the long-term consequences of state funding. The ease of collecting funds by using the state as a governmental United Way will lead to an increased demand for state support. This increased demand will put upward pressure on state budgets, translating into higher taxes. In the long run, we all pay.

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The second response, generally heard from legislators, is that the state is always spending tax dollars on "bad" or "poor" people and it is only fair that we give some money to "good" middle class people and their activities. But because the bulk of the tax burden rests on the shoulders of the middle class, where is the gain? And because there is the cost of an added bureaucracy to collect and distribute the funds, the community suffers a net loss.

Forcing the general public to collectively support community organizations, no matter how worthy they may be, does long-term economic harm. Taxpayers are hurt by having less money to spend, and community organizations are hurt because they ultimately become dependent upon the state, where decisions are based on politics, not on merit.

The worth of community organizations is not at issue here. Worth is based on value and need. If people believe an organization is worthwhile, they will voluntarily donate their time or money. Businessmen will donate voluntarily, with an eye on their company's reputation. This is especially true for youth sports groups, where local businessmen often act as sponsors.

But with state funding, the worth of an organization is decided by political processes, not by individual choices. More than our money, state funding takes away our freedom of choice. □