EXTENSIONS OF REMARKS

IMF MUST LEARN FROM ITS PAST MISTAKES

HON. NEWT GINGRICH
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IN THE HOUSE OF REPRESENTATIVES
Tuesday, October 6, 1998

Mr. GINGRICH. Mr. Speaker, the attached op-ed by Martin Feldstein from The Wall Street Journal illustrates why the IMF must learn from its past mistakes. Feldstein suggests that the IMF can redefine itself as a valuable institution by narrowly defining the problem, rebuilding market confidence, and maintaining growth while reducing the current-account deficit. I submit the op-ed to the CONGRESSIONAL RECORD.

[From The Wall Street Journal, Oct. 6, 1998]

FOCUS ON CRISIS MANAGEMENT . . .

(By Martin Feldstein)

International officials and bankers assembled in Washington for the annual meeting of the International Monetary Fund and the World Bank are considering the failures of the past year and what the IMF should do differently in the future.

The fund made three key mistakes: undermining the confidence of global leaders, attempting unnecessary and radical changes in the basic economic structures of the debtor countries, and imposing excessively contractionary monetary and fiscal polices. But the IMF should aim to do more than just avoid these mistakes. It can play a positive role in future crises by coordinating the rescheduling of international obligations between creditors and debtors.

The IMF can also help prevent future crises by creating a collateralized credit facility that lends foreign exchange to governments that are illiquid but internationally solvent—that is, capable of repaying foreign debts through future export surpluses. President Clinton's proposal to create an IMF credit facility, though vague, may be useful in refocusing the fund's activities.

A rapid-payout credit facility can reduce the risk of speculative attacks and induce countries to maintain open capital markets and free trade. Leaders of emerging-market economies see their national capital markets as small relative to the internationally mobile capital that can be arrayed against them. They fear that even if they pursue sound long-run policies, they could suffer from sudden global shifts of sentiment. Unless the global financial system changes to reduce their vulnerability, emerging-market countries may respond by imposing a variety of counterproductive capital controls, leading to restrictions on foreign investment and trade.

LEGISLATED DIVERSION

An international credit facility can work only if it provides credit rapidly, at an above-market interest rate that discourages unnecessary use and in exchange for good collateral. A country can provide such collateral by pledging a share of the foreign exchange earned by its exporters. A country that borrows from this facility would automatically trigger a legislated diversion of all export receipts to a foreign central bank like the Federal Reserve or the Bank of England, with exporters then paid in a mixture of foreign exchange and domestic currency. Any country that contemplates such collateralized borrowing at some future time must embody such an arrangement in both domestic legislation and international agreements well in advance.

A foreign-exchange facility of this sort need not create moral-hazard problems for either the international lenders or the emerging-market countries. Banks and bond holders would still bear the risk that the companies to which they lend are incapable of repaying their loans. They would also not be protected against countries that become internationally insolvent and cannot earn the foreign exchange to meet their international obligations. And high interest rates would discourage the emerging-market countries themselves from any temptation to act imprudently.

The availability of a credit facility could by itself repulse a purely speculative attack on a healthy currency. When the attack is on the currency of an economy with an overvalued exchange rate that causes an unsustainable current account deficit, the availability of credit must be combined with a shift to an appropriate exchange rate and a deflation of domestic demand to make room for increased net exports.

When crises do occur, the IMF should help by bringing together the creditors and debtors to work out orderly reschedulings of international obligations. The lengthening of debt maturities gives debtor countries the time to earn the foreign exchange needed to meet their obligations. In the case of South Korea, the Fed took the lead and brought along the other major central banks. But since the problem is inherently international and the adjustment process must be monitored, this should be the primary responsibility of the IMF.

The fund must also abandon the mistaken strategy that contributed to the past year's failures. Asia's ''crisis countries'' bear responsibility for causing their own problems through unsustainable current-account deficits and short-term foreign debts that exceeded their foreign-exchange reserves. But these problems could have been solved less painfully. These economies are fundamentally sound, with remarkable long-term growth of both gross domestic product and exports. With modest adjustments, they could easily have earned extra foreign exchange to repay foreign debts. The problem was temporary illiquidity, not insolvency.

When these countries came to the IMF for assistance, it should have seen its task as providing liquidity, supervision and negotiating assistance. Instead, it publicly criticized them as incompetent, corrupt countries with fundamentally unsound economies. In doing so, it not only discouraged any further lending or investment in these countries but also undermined the confidence of global lenders in emerging-market countries generally, thereby contributing to the contagion the IMF wanted to prevent.

Although the IMF organized massive potential loan funds for each of the Asian crisis countries, it did not use those funds to prevent currency runs. On the contrary, it announced that these funds would be provided only if the country accepted the IMF's advice about the radical restructuring of the entire domestic economy—labor rules, corporate governance, tax systems and other matters not germane to the short-run financial crisis. Moreover, the funds would be given out only gradually, as the countries made IMF-prescribed changes. Since this policy meant the IMF would not provide the funds needed to repulse speculators, it caused excessive declines of currency values and required extremely high interest rates to prevent further declines.

IMF Managing Director Michel Camdessus has said that if the IMF had only wanted to deal with the countries' liquidity and debt problems, it would by now have succeeded. He then repeated his earlier statement that the Asian crisis was really a ''blessing in disguise'' because it gave the IMF the leverage to force structural policy changes that the national governments would not otherwise adopt.

This is a remarkable confession of the arrogance and inappropriateness of the IMF policies. Even apart from whether the IMF has any legitimate right to usurp these sovereign responsibilities, the attempt to remake an economy in the midst of a currency crisis made it likely that there would be neither fundamental restructuring nor a rapid resolution of the currency crisis itself. By putting every aspect of these economies into flux, the IMF made it more difficult to make the changes needed to regain access to international capital. Creating massive bankruptcies and widespread political unrest is not conducive to attracting a return of foreign investors.

MASSIVE RECESSIONS

While most of the target countries did need to contract domestic demand in order to reduce imports and provide scope for more exports, the IMF's policies of high interest rates and big tax increases were too contractionary in most countries. This IMF implicitly acknowledged this when it relaxed those policies—but this easing came too late to prevent massive recessions.

The IMF should commit itself publicly to avoiding a repetition of its recent mistakes. Future IMF programs for crisis countries should define the problem narrowly in terms of the country's current-account deficit, the structure of its balance sheet and the soundness of its banks. The guiding concepts should be rebuilding market confidence, focusing on the specific liquidity problems and maintaining as much growth as possible while reducing the current-account deficit. The world will be watching closely to see if the IMF can redefine itself as a valuable institution.

INDIA SHOULD BE DECLARED A TERRORIST STATE

HON. EDOLPHUS TOWNS
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IN THE HOUSE OF REPRESENTATIVES
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Mr. TOWNS. Mr. Speaker, the August 14 issue of News India-Times carried a very interesting story. Kuldip Nayar, a veteran journalist and former Indian Ambassador to the United Kingdom who is now a member of the upper house of India's Parliament, admitted that India is a terrorist state. How long will it take for America to admit it?