Testimony of Walden Bello before Banking Oversight Subcommittee, Banking and Financial Services Committee, US House of Representatives, April 21,1998

Let me first of all thank the members of the House Banking Committee for inviting me to participate in these crucial hearings on the proposed $14.5 billion replenishment for the International Monetary Fund. I am glad and grateful that a representative of the non-governmental community in Asia is being encouraged to share his views on an issue of paramount importance, before a vote of historic international significance.

Allow me to state at the outset that the IMF's record in the Asian region does not inspire confidence in the institution nor in the possibility that the appropriated funds will be used wisely. I urge you to vote against the Clinton administration's proposal for the following reasons:

First, the Fund, by promoting a policy of indiscriminate capital account liberalization among the East Asian economies, has been a central reason for the Asian financial crisis.

Second, the IMF has exhibited a remarkable inability to anticipate and to predict the financial crisis because it is imprisoned by an economic paradigm that severely underestimates the destabilizing effects of unregulated global capital markets.

Third, the Fund is imposing stabilization and recovery programs that are worsening instead of alleviating the economic crisis in the region, raising the specter of a decade of stagnation, if not worse.

Fourth, the IMF is not so restoring our economies to health as bailing out the big international creditors. By not allowing the latter to face market penalities, the Fund is practising what many in Asia sarcastically term "socialism for the global financial elite."

Fifth, the Fund is being brazenly used by the Clinton administration as an instrument to promote the bilateral trade and investment objectives of the US, leading to the weakening of the legtimacy of the IMF as a multilateral institution and to a backlash that could hurt America's ties with the region.

Sixth, the IMF, for its own bureaucratic self-interest, is preventing the Asian countries from developing innovative responses to the Asian financial crisis that would not be dependent on US taxpayers' money.

Finally, replenishing the Fund would promote the Clinton administration's objective of monopolizing foreign economic policymaking at the expense of Congress' development that I, though not a US citizen, disapprove of as a partisan of democracy since decentralized, dispersed power provides the best condition for the exercise of democracy.

Indiscriminate Capital Account Liberalization

I think it can no longer be denied that the Fund was central to the development of the East Asian financial crisis. Two of the countries that are now in trouble, Indonesia and Thailand, were, not too long ago, the two model pupils of the Fund, for following the IMF's prescriptions, particularly on capital account liberalization. Until last July, Indonesia was consistently praised for having liberalized its capital account as early as the 1970's, making it the leader, in the view of the Fund and the World Bank, in Southeast Asian financial reform. The Bank of Thailand was also put on a pedestal as a model for central banks in the regions. The Bank of Thailand and the Thai financial ministry were especially complimented by the Fund for carrying out radical measures of liberalization in the early 1990's.

Let me focus initialy on Thailand since it illustrates very clearly the problem with the Fund and its prescription of indiscriminate capital account liberalization. Prior to 1992, Thailand's financial system was highly regulated. While foreign capital played a limited role in the financial sector, the latter was also insulated from the highly destabilizing inflows and outflows of unregulated portfolio investment and bank capital. In 1992 and 1993, owing to IMF pressure, a set of radical deregulatory moves were carried out, which included: the removal of ceilings on various kinds of savings and time deposits; fewer constraints on the portfolio management of financial institutions and commercial banks; looser rules on capital adequacy and expansion of the field of operations of commercial banks and financial institutions; dismantling of all significant foreign exchange controls; and establishment of the Bangkok International Banking Facility (BIBF).

The BIBF was perhaps the most significant step taken by the Thais in the direction of financial liberalization. This was a system in which local and foreign banks were allowed to engage in both offshore and onshore lending activities. BIBF licensees were allowed to accept deposits in foreign currencies and to lend in foreign currencies, both to residents and non-residents, for both domestic and foreign investments. BIBF dollar loans soon became the conduit for most foreign capital entering Thailand, which came to about $50 billion between 1993 and 1996. With liberalization of the stock exchange, net portfolio investment also zoomed up, so that by late 1996, there was some $24 billion in hot money sloshing around in Bangkok parked in stocks, corporate paper, or in non-resident bank accounts. This was a massive amount of money entering--in a very short period of time--a country which had no period experience handling such an infusion.

What both the IMF and its Thai pupils failed to foresee was that while the liberalized capital account would be the conduit for huge capital inflows when there was confidence in the country, it would also be the wide highway through which capital would flee at the slightest sign of trouble. And, indeed, this is what happened in 1997, when billions of dollars exited in panic, bringing down the currency and the whole economy in the process.

Blindsided by Ideology

Thailand's financial crisis was about two years old before it got global attention with the dramatic devaluation of the baht on July 2, 1997. However, it cannot be said that either the IMF or its sister institution, the World Bank, was worried about the possible consequences of the massive inflows of foreign capital in the form of portfolio investments and loans contracted by the Thai private sector .

At the height of the borrowing binge in 1994, the World Bank's line on Thailand in its annual report was:

Thailand provides an excellent example of the dividends to be obtained through outward orientation, receptivity to foreign investment, and a market-friendly philosophy backed up by conservative macro-economic management and cautious external borrowing policies.

As for the Fund, as late as the latter part 1996, while expressing some concern with the huge capital inflows, it was still praising Thai authorities for their consistent record of sound macroeconomic management policies.

The complacency of the Bretton Woods institutions stemmed from the assumption that the massive capital inflows were fine so long as they were incurred by the private sector and not by the government to fund the latter's deficit spending. Indeed, the high levels of debt of the mid-1990's coincided with the government running budget surpluses or very slight deficits. In the IMF's view, that the country's debt skyrocketed from $21 billion in 1988 to $55 billion by 1994 to $89 billion by 1996 was no cause for alarm because it was mainly the private sector that was contracting the debt. In 1996, the private sector accounted for 80 per cent of Thailand's external debt. In other words, the market would ensure that equilibrium would be achieved in the capital transactions between private international creditors and investors and private domestic banks and enterprises. So not to worry.

As we now know, leaving things to unregulated market forces led to a situation whereby massive amounts of capital went, not to productive investment in manufacturing or industry, but to high-yield areas with a quick turnaround time, like real estate, car financing, and massive credit creation. The consequent massive oversupply of real estate - some $20 billion of residential and office buildings could not be moved by 1995 - triggered not a simple correction but a crash.

That equilibrium would entail such a painful adjustment owing to the irrationality of global capital markets was not something that the Fund factored into the equation when it promoted radical financial market liberalization. This was a post-crisis realization, although the Fund is now rewriting history saying that it had all along been warning the Thai government of the consequences of the massive capital inflows.

But what is a matter of great surprise to most of us in Asia is that despite the lessons of indiscriminate capital liberalization, the Fund's basic solution to the financial crisis is for Asian countries to liberalize our capital account and financial sectors even more. The solution is not just transparency, as Fund officials are now fond of arguing, but greater government regulation of capital flows, such as placing limits on bank exposure to real estate or creating mechanisms to limit portfolio investment, is the crying need. The Fund, however, has a negative view of such regulatory tools.

A Cure Worse than the Disease

As many have already pointed out, the financial crisis in Asia is a crisis of the market, of the private sector. Yet the solution of the IMF is to impose the traditional Fund solution that addresses mainly a problem of severe government indebtedness by cutting back on government expenditures and requiring government to produce a surplus. The problem is also one not of severe inflationary pressures, which is why another element of the traditional IMF formula, raising interest rates, is questionable. The upshot of the IMF formula is to add deflationary pressures that aggravate the recessionary effects of the financial crisis instead of putting into motion countercyclical mechanisms such as increased government capital expenditures that would arrest the decline in private sector activity.

The aim of the IMF program is supposedly to achieve what IMF bureaucrats see as the centerpiece of the program: the return of foreign capital. This the reason why they defend in particular the maintenance of high interest rates. There are two problems with this. First a program of recovery demands a more diverse platform than just waiting for foreign investors to return. As a fund manager of American Express International has said with respect to the IMF program in Thailand, "The only card the government has to play right now is the return of foreign investors. It's disconcerting that everything rests on the return of foreign investors."┐ Second, even granting that focusing on the return of foreign investors alone is a valid strategy, how on earth are they expected to return and make profitable investments in an economy where one is engineering a deep recession?

The dangers of imposing the wrong solution are evident in Thailand. At the time of the IMF program in August 1997, the projected GDP growth rate for 1998 was 2.5 per cent. By the time of the first IMF review in early December, after the government began to put into effect the deflationary measures demanded by the IMF, the projection for the GDP growth rate was lowered to 0.6 per cent. By the time of the next IMF review in February 1998, GDP growth was projected at a negative 3.5 per cent; and some quarters in the Chuan Leekpai government estimated that the actual fall in output in the second quarter of this year would be at an annual rate of 6.5 percent.┐

That the Fund's regimen had helped trigger a freefall was admitted by Hubert Neiss, the IMF's Asia-Pacific director, who said that "the economy had slowed down to such an extent that a continued austerity regime may prompt a new economic crisis."┐ The IMF was forced to make a slight concession, which was to allow the government to run a budget deficit of 1-2 per cent of GDP instead of insisting on the original demand to achieve a 1 per cent surplus, but the slight postiive effects of this move are likel y to be neurtralized by the IMF's continuing insistence on high interest rates. In this connection, it must be noted that this is not the only instance in the last few months that an IMF program has accelerated the crisis: the IMF recently admitted in an internal memo that in November, its directive to the Indonesian government to shut down 16 insolvent banks precipitated a run on two thirds oif the country's banks, throwing the country's financial sector into shambles.┐

Not surprisingly, owing to the Fund's lack of concern about the way high interest rates are making survival difficult for local firms, some of Asia's business groups increasingly see IMF programs as geared toward softening the resistance of local firms to takeovers by foreign investors.

Also people in Asia cannot understand why Washington and the IMF are encouraging the Japanese to engage in more government spending, provide tax cuts, and keep interest rates low, when they are prescribing exactly the opposite to the rest of East Asia, in response to the same region-wide crisis.

Building a Safety Net for the Global Financial Elite

While squeezing local businesses, the IMF programs are serving as a safety net for the big Japanese, European, and American banks that have made irresponsible lending decisions. And in this regard, I must stress that European banks collectively are more exposed in East Asia than Japanese banks, who are in second place, and American banks.

To clarify matters, allow me to focus once more on Thailand. "Financing the balance of payments deficit," which is one of the key purposes of the IMF package for Thailand,┐ is a broad canopy that covers servicing the debt of Thailand's private sector. The IMF-assembled funds of $17.2 billion provide an assurance that the government will be able to address the immediate debt service commitments of the private sector, while it is trying, with the support of the IMF, to persuade creditors to roll over or restructure their loans.

The program thus repeats the pattern of the IMF-US Mexican bailout in 1994 and the IMF structural adjustment programs during the Third World debt crisis in the 1980's, in which public money from Northern taxpayers was formally handed over to indebted governments, only to be recycled as debt service payments to commercial bank creditors.

To many of us in Asia, there is something fundamentally wrong about a process that imposes full market penalties on our private sector while sparing international private financial institutions - indeed, socializing the latter's losses. We are not asking the IMF to bail out our firms; we are simply asking for a sharing of the market's punishment for making the wrong decisions. As the Thai newspaper, The Nation, puts it, "The penalties imposed on foreign creditor banks which have lent ot the Thai private sector must be precise and applied equally - Thailand and Thai companies may bear the brunt of the financial crisis but foreign banks must also share part of the cost because of some imprudent lending. It would be irresponsible to lay the blame entirely on Thailand."┐

To exempt the international banks from market penalties will encourage them to continue in irresponsible lending - and here it must be noted that during the mid-1990's, the international banks were often the ones scrambling to lend to Thailand. As one 1995 account put it, "as a result of still competition, pricing levels in some cases are not premised entirely on the financial fundamentals of the borrower. Many banks in Asia are anxious to develop good relations with their Thai counterparts, and are increasingly willing to lend to build relationships."┐

Promoting Anti-Americanism

One of the implications of the IMF programs that this body must seriously consider is the way that they may be promoting a new round of anti-Americanism in the region. This has to do with the way that the Clinton administration has made it clear that it will use the IMF to push the US bilateral economic agenda with East Asia. In the case of Thailand, for instance, United States Trade Representative Charlene Barshfsky has bluntly stated in public that "we expect these [IMF] structural reforms to create new business opportunities for US firms."┐ Indeed, so frank has the administration's statements been in this regard that the Financial Times has reported that US officials have told their "domestic audience that they will use the opportunity provided by the crisis to force radical structural reform on other countries that would amount to what some critics see as an 'Americanization' of the world economy."┐

US trade and investment proposals for the region should be negotiated bilaterally with the different countries involved. The dangers associated with using the IMF to achieve them are clear. First, they may achieve benefits in the short term, but they will ultimately result in great disadvantage to US political and economic interests in the future owing to the great resentment they breed. The US cannot afford to create more enemies. Second, it erodes the legitimacy of the IMF, making it increasingly look like an extension of the US Treasury Department and Commerce Department, thus weakening its role in a multilateral world order and bringing us all back to a unilateralist way of resolving disagreements - precisely the approach that the administration itself has disavowed.

Creating Poverty and Instability

In a recent statement that appeared in the International Herald Tribune, Michel Camdessus, the managing director of the IMF, said among the basis of IMF programs must be "a more effective dialogue with labor and the rest of civil soceity to increase political support for adjustment and reform."┐ Well, this is certainly not the case with any of programs in Indonesia, Thailand, or Korea. In all of these countries, the IMF programs were designed behind closed doors, between IMF bureaucrats and government technocrats, with the participation of few elected officials and little input from labor unions, non-governmental organizations, and people's organizations. In Indonesia, negotiations on the program have taken place strictly between IMF officials and a few trusted lieutenants of a dictator.

Now, this lack of democratic legitimation of IMF programs may prove to be explosive in the coming months as the population is forced to bear the brunt of the costs of the profligacy and irresponsibility of the local business and international banks. In September 1997, then Finance Minister Thanong Bidaya announced that about one million workers would lose their job in the coming recession.┐ As of February 1998, some 80,000 workers had already been thrown out of work.┐ With the downturn expected to be much worse than projected, it is likely that the unemployment rate could reach as high as 15-20 per cent of the work force of 2.9 million people. In Indonesia, the economic freefall, according to economist Faisal Basri, has raised the number of people living under the poverty line to 118.5 million people from 22.5 million - that is from 11.2 per cent of the population to 60.6 per cent.!┐ The ranks of the unemployed is expected to reach 13 million in the next few months.┐ In Korea, many observers estimate that the numbers of unemployed will exceed two million by the end of 1998, or 9 per cent of the work force. Women are likely the first to be layed off, and women with children are likely to be laid off first. This will require a great deal of psychological adjustment on the part of a work force that is accustomed to a system of lifetime employment with no unemployment insurance.┐ That the adjustment is extremely traumatic is underlined by the increasing number of what Koreans call "IMF suicides" of layed off workers who also take with them their wife and children to the after life, most likely because of their worry that no one will be left to provide for them in this life.┐

A few weeks ago, Thais were treated to a preview of things to come when we woke up to a veritable mini-uprising by workers at a Thai auto parts firm. The event, which was seen worldwide via CNN, began when the workers blocked a major highway as a response to the firm's announcement that it would not be able to give them their much-awaited bonuses owing to the financial crisis. There followed several hours of pitched battles that pitted the workers against the police and angry motorists, ending woith the wholesale arrest of scores of workers whowere herded in prisoner-of-war fashion into police vans. To Thais, who are known for their confrontative ways, the television images of the event reminded them more of Korea than of Thailand.

Institutionalizing Stagnation

Jeff Garten, Undersecretary of Commerce during President Clinton's first term in office, has said that the countries of East Asia "are going through a deep and dark tunnel" in the next few years.┐ What lies at the end of that tunnel, many fear, is a condition akin to that of the Philippines, an Asian country that was known until just a few years ago as the "sickman of Asia."

The Philippines, as President Fidel Ramos told you two weeks ago when he was visiting Washington, has been under one or other IMF program for the last 36 years. The height of the IMF years ocurrred in the period 1983-1993, when the country was subjected to successive programs of structural adjustment. The main aim of economic policy during this period to which all other objectives were subordinated was repaying the foreign debt. The economic formula consisted of sharp cutbacks in government spending, high interest rates, liberalization, deregulation, and privatization. Not surprisingly, the economy registered zero average growth during that decade, causing the country to fall far behind its neighbors which were growing by 6 to 10 per cent. In the 1970ís, the Philippines was known as Southeast Asia's most advanced large economy. Its economy was as large as Thailand's. By the early 1990's, a combination of rapid growth in Thailand and a dose of Marcos economics followed by IMF adjustment in the Philippines resulted in situation wherein the Thai economy was more than twice that of the Philippines.

Not surprisingly, the country was afflicted with the highest poverty incidence among the non-communist Asian countries and one of the most unequal distributions of income and wealth.

The Philippines economy has grown again modestly in the last few years - mainly because we had sunk so low that we had nowhere to go but up. Yet even this modest growth threatens to be choked off by a potent combination of the financial crisis and a "precautionary" program of the IMF - what people sarcastically call a "post-graduate program" since we were supposed to have exited from the Fund on March 31 this year.

This program calls on the government to fall in line with our neighbors by keeping interest rates high, produce a budget surplus, and export our way out of the crisis. As a result, our modest growth is likely to give way to a recession, unemployment is expected to reach 15 per cent of the work force, and our poverty incidence, after stabilizing for a few years, is likely to worsen. Moreover, with greater competition for export markets from our neighbors, with their newly devalued currencies, the IMF prescription to export our way out of the crisis is leading us to more intensively exploit our natural resources and environment. Just last week, the Ramos administration tried to lift a ban on the export of lumber, which had been instituted a decade ago to protect our last remaining forests.

The Philippines is no exception to the Asian gloom, Like our neighbors, we are headed for the same "deep and dark tunnel," as Jeff Garten calls it, pulled by the same IMF locomotive.

Monopolizing Solutions and Erording Congress's Authority

One of the biggest myths around these days is the indispensability of the Fund to a resolution of the Asian financial crisis. In fact, the Asian countries did produce an alternative institution and process to stabilize the financial situation in the region in the fall of last year, one which would not entail additional dollar appropriations by the US Congress. I think it is important to note here that contrary to the administrationís claim that Japan is not doing anything to help its neighbors get out of the crisis, the Japanese government was willing to put up a considerable part of the resources for this alternative approach.

The alternative approach came in the form of the Japanese proposal to establish the "Asian Monetary Fund " (AMF) last August. The Fund, with a possible capitalization of $100 billion (all of it drawn from Asian countries) was envisioned as a multipurpose fund that would assist Asian economies in defending their currencies against speculators, provide emergency balance-of-payments financing, and make available long-term funding for economic adjustment purposes. As outlined by the influential Ministry of Finance official Eisuke Sakakibara, the fund would be a quick-disbursing mechanism that would be more flexible than the IMF by requiring a less uniform and less deflationary set of policy reforms as conditions for receiving help.┐ The AMF had the backing of all the Asian countries, with Taiwan and China being on the same side for once.

Not surprisingly, IMF Managing Director Camdessus and his deputy, Stanley Fischer,argued against the establishment of the AMF. The stated rationale was that the AMF would subvert the IMF's ability to secure tough economic reforms from Asian countries. The reality was that the AMF would threaten the IMF's monopoly on the making of policy for dealing with the financial crisis. The Clinton administration, without consulting Congress, backed the IMF leadership and "made considerable efforts to kill Tokyo's proposal."┐ One of the key reasons is that, with increasing Congress' increasing assertiveness in foreign economic policy using its power of the purse, the Clinton administration sees the IMF as an increasingly important instrument to push key initiatives without having to submit them to Congressional oversight.

Faced with the administration's opposition, the Japanese government withdrew the proposal and with that went the promise to commit substantial sums of money. With Japan retreating, the Taiwanese and the Chinese also withdrew their promise to commit their tremendous reserves to dealing with the crisis. Instead of these countries bearing the costs of the adjustment and recovery of their neighbors, the clinton administration is now asking you, the Congress, for this money in the form of the $14.5 billion IMF replenishment fund.

Recommendations

In conclusion, I join many of those who recommend withholding the $14.5 billion from the Fund. The world will not come to an end without an IMF replenishment. In fact, I daresay that the with IMF resources reduced, the Asian countries will be forced to come up with innovative, self-help cooperative solutions, like some revived version of the Asian Monetary Fund, to deal with the financial crisis that would not be a drain on American taxpayers' money. Giving the Fund the replenishment at this time will only allow IMF bureaucrats to dig in their heels against the much needed reform of their structures of decisionmaking and accountability and the urgently needed review of their failed policies. Giving the replenishment at this time will only encourage persistence in economic programs that perpetuate dependence on the Fund and American taxpayers' money rather than promote financial independence. Giving the replenishment will only serve to strengthen the executive's drive to monopolize foreign economic policymaking at the expense of Congress.

I thank you.

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