

# REFORM OF THE IMF AND WORLD BANK

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**HEARING**

before the

**JOINT ECONOMIC COMMITTEE  
CONGRESS OF THE UNITED STATES**

**ONE HUNDRED SIXTH CONGRESS**

**SECOND SESSION**

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**April 12, 2000**  
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Printed for the use of the Joint Economic Committee



U.S. GOVERNMENT PRINTING OFFICE

WASHINGTON: 2000

cc 64-877

For sale by the U.S. Government Printing Office  
Superintendent of Documents, Congressional Sales Office, Washington, D.C. 20402

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[Created pursuant to Sec. 5(a) of Public Law 304, 79th Congress]

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Statement before the Joint Economic Committee  
of the United States Congress

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April 12, 2000

Mr. Chairman, thank you for inviting me to appear here today. I want to begin by commending you and the Joint Economic Committee for having maintained over the last several years an open and lively forum for debate on reforming the IMF and the development banks.

It was a privilege for me to serve on the Meltzer Commission. We considered a remarkably broad range of issues, unearthed significant new information pertaining to the international financial institutions' policies, and made what I think are a set of careful and creative suggestions for reform. Others may disagree with us on the details of our recommendations, but I hope they will agree that our deliberations were a good faith effort, as is apparent in the strong bipartisan majority that voted for the Commission report.

In my previous testimony before the House and Senate Banking Committees, I outlined the Commission's recommendations, explained the rationale behind them, and responded to Secretary Summers' preliminary reactions to our report. Given the substantial common ground between Secretary Summers and the Commission, it is my hope and belief that most or all of the Secretary's doubts about our recommendations will be resolved by a fuller consideration of the logic that underlies them. I will not reiterate my previous testimony here today, but I am happy to answer any questions you or members of the Committee may have on these topics. I do, however, want to emphasize one point that received less attention in the earlier Congressional hearings.

A basic premise of our report is that the international financial institutions should be transformed into effective *economic mechanisms*. To be effective as economic mechanisms – that is, to avoid being employed

merely as political slush funds for broad foreign policy objectives – they must have clearly defined goals, and they must meet disclosure and governance standards that ensure that they stay true to those goals.

Some members of the Commission – notably Mr. Levinsohn – have disagreed with the majority’s view on this point. This, rather than the details of the economic reasoning of the majority, I believe, lies at the heart of the disagreement between the majority of the Commission and our critics. I think it is fair to say that Mr. Levinsohn, in particular, sees the multilateral agencies largely as vehicles of American foreign policy. Some observers might be forgiven for concluding from his remarks that he intends to use the IMF, WTO, and development banks as tools to further the protectionist interests of America’s labor unions. I note, however, that this is not what Mr. Levinsohn says motivates his statements, and I think it would be wrong to question his motives. Rather, I want to question his central premise: that the IMF and the World Bank should be used as tools to pressure countries to adopt particular policies in pursuit of American interests.

I think, instead, that foreign aid should serve that function, and in so doing, aid should be subject to parliamentary oversight – consistent with the essential balance of power envisioned by our Constitution.

The role of the multilateral institutions should be fundamentally different from that of foreign policy. The multilateral institutions should improve the world economy by providing (first) global public goods (e.g., liquidity, the rule of law in international trade, and improvements in public health technology), (second) solutions to problems of negative externalities across countries (e.g., pollution and economic instability that spill across

national boundaries), and (third) an effective means for coordinating the attack on poverty in the poorest countries.

These are sufficient challenges for the IMF, the development banks, the BIS, and the WTO. Adding a broad, discretionary foreign policy role to that list of challenges is highly counterproductive. It crowds out scarce resources that are needed for bona fide economic objectives. It distracts the management of the institutions, and forces them to depart from clear rules and objectives. It makes it hard to establish norms for the conduct of management and mechanisms to ensure accountability, and thus erodes the institutional integrity and credibility of the multilaterals.

The IMF's Russian fiasco of 1997-1998 illustrates that point nicely, as does the IMF's current program with Ecuador. No knowledgeable observer of Ecuador with whom I have spoken believes that Ecuador will adhere to the fiscal or regulatory reform conditions that the IMF is attaching to its proffered loan subsidies. Nor does anyone regard Ecuador's problem as one of illiquidity. Ecuador has been suffering a deepening fiscal crisis for several years, caused by the combination of an unresolved internal political struggle, weak banking system regulation, and severe adverse economic shocks.

Under current circumstances it is very hard to argue that channeling IMF loan subsidies to Ecuador makes sense either as a means of mitigating an illiquidity crisis or of spurring institutional reform. Some observers have argued that IMF aid is probably better understood as a means of sending political payola to the Ecuadoran government at a time when the U.S. wishes to ensure continuing use of its military bases there for monitoring drug traffic. I am not sure if that perspective is correct, but if the United

States wishes to provide foreign aid to Ecuador because of its value as a strategic military base for monitoring drug trafficking, let that policy be debated in Congress, and let our government decide whether to do so.

Dragging the IMF into this affair only further weakens that institution's already damaged credibility.

I emphasize that I am not arguing against foreign aid, but rather for a separation between foreign aid broadly defined and the mandates of the international financial institutions.

That principle also explains why I do not think that the development banks, the IMF, or the WTO should require member states to adhere to specific rules governing their domestic economies, *unless those rules are necessary for the successful implementation of the narrowly defined economic objectives of the international institutions*. Let me clarify this point. Prudential regulatory standards for banks are a reasonable requirement for the IMF to impose on would-be borrowers, since that requirement reduces the possibility of the abuse of IMF loans. That goal, not a general desire to impose bank regulatory standards, motivates the Commission's recommendations in this area.

In this light, it is clear why so called "core labor standards" were not an element of our suggested prequalification requirements for the IMF. Similarly, because we saw the role of the multilaterals as confined to providing global public goods, poverty alleviation, and solutions to externalities across countries – and not to encroaching on national sovereignty for its own sake – we did not recommend that the World Bank or the WTO encourage (either through carrots or sticks) the adoption of core labor standards.

In this regard, I would like to clarify a statement that I made during the Commission hearings, which Mr. Levinsohn has repeatedly quoted – one which pertains to U.S. trade policy as well as to the appropriate use of conditionality by the multilateral institutions. In my view, the effect of imposing core labor standards on other countries through threats of protectionist policies is both disadvantageous to Americans and immoral. It is disadvantageous to us because it raises the cost of U.S. consumer goods. It is immoral because the effect of those standards in developing economies would be to prevent poor people (especially under-age poor people) from earning essential income necessary to feed, clothe, and house themselves.

Nonetheless, I would not argue (and did not argue during our hearings) that the United States should always be willing to trade with any country, or that countries should be allowed to participate in the multilateral institutions no matter what their domestic policies. For example, I specifically noted that countries like Nazi Germany were clear examples of evil, abusive regimes, which so violated the basic human rights of their citizens that it would be unconscionable to trade with them, much less to support them. There may be examples in today's world that cross that line. But permitting starving ten-year olds to work should not be sufficient to place a country on that black list.

Mr. Chairman, again I thank you and the Committee for inviting me, and for your attention. I look forward to your questions.