

REFORM OF THE IMF AND WORLD BANK

HEARING

before the

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

ONE HUNDRED SIXTH CONGRESS

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—————
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Wednesday, April 12, 2000

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
WASHINGTON, D.C.

The Committee met, pursuant to notice, at 9:30 a.m., in Room 311, Cannon House Office Building, the Honorable Jim Saxton, Vice Chairman of the Committee, presiding.

Present: Representatives Saxton, Sanford, Doolittle, Ryan, Stark, Maloney, Minge and Watt.

Staff Present: Christopher Frenze, Robert Keleher, Darryl Evans, Stephen Thompson, Colleen J. Healy, Howard Rosen, Daphne Clones, and Leah Liston.

OPENING STATEMENT OF

REPRESENTATIVE JIM SAXTON, VICE CHAIRMAN

Representative Saxton. Good morning. It is a pleasure to welcome Dr. Meltzer and Dr. Lerrick, Dr. Calomiris, Mr. Levinson to the Committee this morning. As most everybody here knows, Dr. Meltzer serves as Chairman of the International Financial Institutions Advisory Commission (IFIAC), and the other members of the panel are also associated with the Commission. I would like to compliment you for taking the time and effort to grapple with some of the most complex and challenging issues in economic policy and producing such an excellent report.

Today we plan to focus on the substantive economic and financial issues related to the International Monetary Fund (IMF) and the World Bank and how they relate to proposals for reform. As one who has been involved in issues related to reform of the IMF for several years, I am encouraged by the emerging consensus that has developed on some basic principles relating to these important issues. The principles that now enjoy broad support include: first, the IMF should provide more transparency; second, the IMF should focus on short-term crisis lending; third, the IMF should scale back development lending; and fourth, the IMF should end interest rate subsidies.

There is significant agreement on a range of other issues as well. The main question remaining is how to consistently apply these concepts to IMF reform. Tactical differences in the applications of these principles

should not be permitted to distract attention from how much consensus has been achieved on basic principles for IMF reform. For example, recently Secretary Summers has called on the IMF to focus on crisis lending while deemphasizing development lending and raise at least some IMF interest rates. This is very encouraging to those of us in Congress who have supported these objectives for quite some time and thus welcomed Summers' support of IMF reform. As news reports noted at the time, Mr. Summers seemed to borrow heavily from congressional critics of the IMF and from the expected recommendations of the Meltzer Commission.

Our perspective here at the Joint Economic Committee (JEC) has focused on transparency and the finances of the IMF. These two issues are closely related and have important implications for Congress. As a former IMF research director recently said, "the Fund's jerry-built structure of financial provisions has meant that almost nobody outside, and indeed, few inside the Fund, understand how the organization works."

However, the IMF is a publicly financed institution in which the U.S. has a prominent financial and policy-making role. Congress has an important responsibility to monitor how effectively taxpayer funds are being used and ensure that adequate safeguards are in place. Obviously, this lack of IMF transparency undermines Congress's ability to carry out this oversight responsibility. We have finally managed to decipher and decode the IMF's accounts, but IMF finances really are not understandable and do not comply with the transparency standards the IMF imposes on others.

Our Committee findings show that the base of the IMF financial support is much narrower, for example, than officially portrayed, with the U.S. contributing 26 percent of the IMF's usable resources and the G-10 countries contributing a full 77 percent of the IMF's usable resources. Over half the IMF membership contributes virtually no usable funds at all. Furthermore, in one recent period, 70 percent of the IMF credit was owed by just five borrowers. Russia and Indonesia together accounted for one-third of the outstanding credit. IMF interest rates are currently about 4.7 percent, far below the market rates available to IMF borrowers and below the rates available to the most creditworthy nations, such as the U.S.

Two years ago the Joint Economic Committee also found there were no effective safeguards or accounting controls in place to monitor IMF loan disbursements. Billions of dollars would be disbursed by the IMF

with no effective accounting controls in place to enable the IMF to verify information and ensure that funds were properly used. Given the rather low public integrity standards in place among many IMF borrowers, this cavalier approach fails to take into account the fiduciary responsibility of the Fund to member countries and their taxpayers. After repeated public embarrassments, and my introduction of legislation mandating IMF accounting controls, it is good to see that the IMF is finally taking long overdue steps to address some of these issues.

Although most of our research at the Committee has focused on the IMF, reform of the World Bank is also needed. The overlap of IMF and World Bank development activities is acknowledged by each agency, but is apparently not viewed as a problem. Not only is the IMF involved in many development activities, but the World Bank has participated in bailouts during economic crises.

A clear distinction between the different missions of the IMF and World Bank is urgently needed, and this problem is also addressed by the Meltzer Commission.

The congressional agenda for reform of the IMF and the World Bank is an ambitious and compelling one. However, in the case of the IMF, the Congress has provided over one-quarter of the usable resources, more than the three next largest contributors all combined. Over time a continual assertion of congressional pressure can make a tremendous difference, and this is the intent of the *IMF Reform Act of 2000*, which I recently introduced. Congress is in debt to Chairman Meltzer and the Commission for providing an excellent blueprint for reform of the IMF and World Bank.

Before we go to the Commission, Dr. Meltzer and others, are there other Members who may have opening statements?

Mr. Minge.

[The prepared statement of Representative Saxton, together with the *IMF Reform Act of 2000* (H.R. 3750) appear in the Submissions for the Record on page 48.]

Representative Minge. Thank you. I would just like to make sure that we have submitted for the record an opening statement from Congressman Stark.

Representative Saxton. Without objection.

[The prepared statement of Representative Stark appears in the Submissions for the Record on page 58.]

Representative Minge. I would also like to just briefly note that I have been corresponding with the Chair of the Joint Economic Committee concerning the importance of holding a hearing on the balance of trade issue and the trade deficit that we have in the United States and the problems of a strong dollar, and I hope that this Committee will be able to move ahead to do that. I think these are two very important considerations for the American economy. In the short term, they may not appear to be as significant, but in the long term I think that if we don't address them, we are going to reap the consequences. So I hope we can do that, and with that I close my statement.

Representative Saxton. Thank you, Mr. Minge. Mr. Doolittle.

OPENING STATEMENT OF

REPRESENTATIVE JOHN T. DOOLITTLE

Representative Doolittle. Thank you, Mr. Chairman. I look forward to hearing the proposals to reform the IMF and the World Bank, and I thank you, Mr. Chairman, for performing a valuable service by focusing attention on this issue. Restructuring and cutting back the powers of the International Monetary Fund, I think, is clearly necessary considering its role in the recent financial crises across the world.

The record of the IMF as banker to governments in financial distress has not inspired confidence. The IMF egregiously violates sound banking practices, calling into question its condemnation of the poor financial systems of loan recipients. Most recently the decision to lend to Russia, a country that has defaulted on its debt and shows little dedication to economic reform, demonstrates that the IMF is a poor role model for sound banking. Although the circumstances leading to financial crisis in Latin America, Asia, and Russia differ in many respects, a common thread was a lack of adequate banking supervision, transparency, and oversight.

Many countries use the banking system as an instrument of development strategy. The government chooses industries and ventures it believes will contribute to development. It then directs credit to these winners, often by encouraging commercial lenders to favor those industries. This policy undermines the growth of the sound banking system by preventing banks from assessing loan applications on the basis of such criteria as likelihood of repayment and available collateral. These

highly regulated banking systems provide the perfect means for corrupt officials to funnel funds to politically-connected industries and individuals. Overall financial instability increases because loan assessments based on economic and business criteria including financial viability are suppressed in favor of loans made for political priorities. Such a system produces more bad loans and losses than a banking system based on sound credit practices.

In exchange for billions in credit to governments around the world, the IMF requires countries to implement specific policy changes to address the cause of the financial instability. Broad financial service reform, especially of commercial banking, has become a favorite IMF policy prescription. Typically this includes writing off bad loans, closing bankrupt institutions, and improving oversight of banking practices.

Would that the IMF followed its own advice. Instead of restricting or denying credit to countries with a record of resisting economic reform, the IMF eagerly enters into loan after loan. The most recent glaring example of this practice is Russia. Despite over \$27 billion in IMF credit since 1992, the Russian Government has been unwilling or unable to reform the economy. It has defaulted on much of its debt. It has even admitted that as much as \$50 billion in central bank reserves, including IMF loan proceeds, was siphoned off for questionable purposes with the cooperation of Russian officials.

Russia is the most recent example of decades of poor banking practices on the part of the IMF. Another is Peru, which entered into 17 different arrangements with the IMF between 1971 and 1977 despite repeated failure to meet many of the reform conditions that accompanied the loans. In effect, these IMF loans financed destructive economic policies that made Peru less able to repay its debt. A third example is a \$3.4 billion IMF loan to Mexico, only one year after that country had initiated the 1982 Latin American debt crisis by defaulting on its debt.

Despite the IMF's vocal support for sound banking principles, its actions tell a different story. The IMF exports poor banking practice by example. It damages the international financial system when it continues to lend to countries like Russia, a financial black hole. In an October 1998 statement, the IMF noted that, quote, markets do not operate well when transparency and accountability are lacking and market participants do not operate under an internationally accepted set of principles or standards, end of quote. The world economy will continue to suffer so long as IMF actions fail to match IMF rhetoric.

[The prepared statement of Representative Doolittle appears in the Submissions for the Record on page 61.]

Representative Saxton. I thank the gentleman. We will proceed with our witnesses at this point. We appreciate your being here and want to express our gratitude for the great job you did, Dr. Meltzer, as Chairman and member of the Commission.

We want to give you plenty of time to express your thoughts on these important issues.

So, Dr. Meltzer, if you would like to begin, and thank you again for being here.

**STATEMENT OF ALLAN H. MELTZER, CHAIRMAN,
INTERNATIONAL FINANCIAL INSTITUTION
ADVISORY COMMISSION**

Dr. Meltzer. Thank you, Mr. Chairman. Thank you for your opening statement. It is fair to say that the Commission followed the lead that you established for us, you and your staff, which was very helpful to us, as I say in my statement.

It is a great pleasure to appear here today to discuss the International Monetary Fund and the international financial institutions. The Joint Economic Committee's leadership and its staff have done valuable and important work to increase understanding of the IMF's working. At the very start of the Commission's work, we turned to the JEC staff for the help that they willingly gave. We are grateful to you, Mr. Vice Chairman, to the Chairman, the Members of the Committee and its staff.

Today I will focus mainly on the IMF and the bipartisan, Majority proposals for reform and change. Two of my colleagues, Dr. Calomiris, who was a member of the Commission, and Dr. Lerrick, who worked as a senior advisor to the Chairman, will talk about other aspects so that we will try to cover a full range of issues.

Our proposals have been publicly available for more than a month. I am pleased to note that they have attracted considerable attention, including favorable editorials in many leading newspapers at home and abroad. Most writers and commentators have suggested that the bipartisan, Majority proposals should serve as the basis for future discussions of reform. The opportunity for reforms that was ignored at the 50th anniversary of the IMF and the Bank has now been revived.

The Majority is grateful that in the month that followed release of the Commission Report, discussion has not only remained active, but earlier vituperation and personal attack have ended. Discussion has been substantive and directed at the issues discussed and raised in the Report. I hope that will remain true today. Once we moved to substance, differences and reasons for differences began to appear. But it also became clear that thoughtful commentators have found considerable common ground, as you pointed out in your opening statement.

I can illustrate some broad agreements by referring to some of Treasury Secretary Summers' recent statements, namely his speech to the Council on Foreign Relations, his testimony to the House Banking Committee, and his recent column in the *Financial Times*.

Secretary Summers' statements of core principles for reform calls for, one, clear delineation of responsibilities between the IMF and the multilateral development banks; two, a refocused IMF that concentrates on short-term liquidity lending; three, the establishment of preconditions to strengthen incentives that forestall crises; and, four, dissemination of information to markets. These statements are entirely in accordance with the Majority Report.

Secretary Summers would assign the development banks responsibility for, one, targeting financial resources to the poorest countries without access to private sector financing; and, two, increasing production of global public goods. He asks for reforms that will provide substantial improvement in the effectiveness of development aid and debt relief for the heavily indebted countries that implement effective economic development strategies. Again, he agrees with the Majority Report.

He agrees, also, that there is costly and wasteful duplication between the World Bank and the regional development banks. Although he does not go as far as the Majority to eliminate that duplication, the differences do not seem great. And he agrees fully with the Majority of the Commission on the need to avoid pegged exchange rates.

On other issues we appear to be farther apart. I am at a loss to understand why he regards our recommendations for preconditions on IMF lending at a penalty rate as a potential source of instability. Countries that have not satisfied the conditions would borrow at a superpenalty rate under the Majority proposal. But this distinction misses a point that we failed to emphasize sufficiently. Countries would have a powerful incentive to meet the preconditions if not in five years, then as quickly as they can.

The reason is that once some countries have qualified, those that have not qualified would face difficulties borrowing in the capital markets. Private lenders would prefer to lend to countries that meet the new international standards. Some would charge a higher rate, but many would avoid lending to countries that do not meet the four preconditions for stability.

The preconditions the Majority chose are not arbitrary. One is an extension of the type of standards for bank capital that developed countries have now adopted based on the Basel agreement. Another is based on the WTO's (World Trade Organization) protocol 5 that permits foreign banks to compete in the country's markets. More than 50 countries have accepted this protocol. The remaining conditions require reasonable fiscal policy and the timely release of information on the maturity distribution of sovereign debt. These seem not only unobjectionable, but necessary for stability. Experience in Latin America has shown how much economic and financial stability improved locally and globally when banks had adequate capital and foreign banks were permitted to compete in Argentina and Brazil.

While no one can guarantee that all crises would be avoided, crises would certainly be reduced in severity, frequency and extent if the financial system and the fiscal system met standards that limited the possibility of financing overly expansive fiscal policies. Real shocks would still occur, but financial expansion cannot solve problems caused by real shocks. The IMF's job is to resolve short-term liquidity problems. Longer-lasting problems and poverty relief that require structural or institutional change should be financed by loans from development banks. These loans and poverty relief would be available from the development banks under the Commission's proposals.

Some critics of the Majority Report, including the one of today's witnesses, claim that the Majority wanted to weaken or destroy the IMF, but instead settled for reducing its role. This is not only incorrect, it totally misses the point of the Majority Report.

The world has lived through a series of deep crises in the last 20 years. The Majority and many others believe there are three major reasons for the depth and frequency of these crises: first, the collapse of pegged exchange rates; second, the collapse of weak financial systems; and third, the long delay between the time a crisis erupts and the time the IMF or others are ready to help. The delay is caused by the long negotiation over the conditions that the crisis country must accept before

help becomes available. Of course, it does not always meet those conditions. In fact, it rarely meets those conditions.

The Majority resolved the three problems by replacing *ex post* conditionality with preconditions that strengthen financial systems and avoid lengthy negotiation. The Majority also favored an end to pegged exchange rates, a view that Secretary Summers shares, as I said, a moment ago.

If future crises are less frequent and less virulent, the IMF's role would be smaller. It would still have a major role as lender of last resort to developing countries and increased responsibility, and I want to emphasize increased responsibility, for marshalling information, increasing its quantity and improving its quality. This role is vital now that we rely principally on markets, not on governments or agencies, to allocate capital to developing countries. Better, more timely information is the enemy of financial crises.

Criticisms of the Majority proposal for the development banks stress the number of poor people in middle-income countries. The number of poor people is an attractive criterion only at first glance. I am confident that on further reflection, reasonable people, including Secretary Summers, will agree with the Commission Majority that a better criterion is the number of people who lack adequate access to resources. China has many poor people. The Majority wants the development banks to continue to give technical assistance and support to China. But China holds more than \$150 billion in foreign exchange reserves and receives private capital inflows that greatly exceed any amounts it receives or is ever likely to receive from the development banks. No less important, a reallocation of development bank lending from China to effective programs in the poorest countries would permit these agencies to increase aid to the poorest countries without – those countries without alternative resources. Dr. Lerrick will talk to that more fully in a few moments.

Some have argued that the market would not finance social services or education. The Majority believes this is a misunderstanding of the banks' practices. The development banks receive government guarantees when they lend. When private lenders have the same guarantees, they are not concerned if the loan finances social reform, education, or other proposals with high social returns but low monetary returns.

Some have pointed to the recycling of loan repayments as a source of aid. The Majority was aware of the need for additional funding for poverty and said so. It is important to recognize, however, that if a

development bank agrees to continue subsidies, many countries, even poor countries, could borrow in the marketplace when they hold a guarantee of 90 percent of the project cost from the development banks. This would reduce the amounts that the banks would show as outstanding loans or pay as granted under our proposal without lowering the resources made available to the poor countries and the programs that could be supported. There is, in short, little reason to believe that our proposals would harm the developing countries. The Majority strongly supported increased assistance to the poorest countries if assistance becomes more effective through closer performance monitoring, use of grants, and other Majority proposals.

I would like to end by raising one issue that is or should be one of the most important issues for the American people. That issue remains unspoken by the critics.

This administration, even more than previous administrations, has used the international financial institutions as sources of readily available funds to support its foreign policy. If it could not make heavily subsidized long-term loans through these institutions to Russia, China, Mexico, Brazil, and other countries whose policies the U.S. wishes to influence, the administration would have to change policy or ask Congress to appropriate the funds. Congress could perform better oversight, would question whether programs are successful and whether they benefit the American people.

This issue is sometimes described as a foreign policy issue. The Commission Majority is accused of interfering with the conduct of foreign policy. This accusation is usually made *sotto voce*. I do not agree with that characterization. The core issue is the constitutional responsibility of Congress to appropriate funds. Administrations for years circumvented the budget process to support Mobutu, Suharto, Marcos, and others. The Majority believes firmly that final decisions about spending should remain with the Congress, not the administration acting through the international financial institutions. This reform is most basic because it deals with legislative responsibilities and constitutional prerogatives that, once sacrificed, are difficult to recover. Thank you, Mr. Chairman.

[The prepared statement of Dr. Meltzer together with the IFIAC Report appear in the Submissions for the Record on page 64.]

Representative Saxton. Dr. Meltzer, thank you very much.
Dr. Lerrick.

**STATEMENT OF ADAM LERRICK, SENIOR ADVISOR,
INTERNATIONAL FINANCIAL INSTITUTION
ADVISORY COMMISSION**

Dr. Lerrick. Good morning, Mr. Chairman. It is a privilege to address the Joint Economic Committee. I have worked with the staff for a number of years, particularly on IMF issues. I am pleased to note that the staff is going to address what is considered at the IMF the final frontier, which is the SDR (special drawing rights) department, which few inside the Fund understand, as well as outside the Fund. But the subject of my remarks this morning is going to be the financing of development grants.

One of the most controversial of the Meltzer Commission's proposals is the change in the format of development aid, the replacement of traditional subsidized loans by grants for infrastructure and social service projects. This is a core issue in the discussion of the effectiveness of aid. Although the concept of grants is familiar, the new model proposed by the Commission is a hybrid variety.

Grants are a gift, but a gift with strings attached. They make possible the funding of a program in full, but are paid only after audited proof of concrete results. They reinforce discipline by demanding a current copayment by the recipient, and they leverage every dollar of scarce aid resources by drawing upon the capacity and skills of the private sector. Even a decade ago, the capital markets did not imagine what they offer routinely today, sheer size, sophistication in instruments and the willingness to tolerate the risk which once deterred projects in the developing world.

Loud and determined voices have risen in protest of the grant concept, all with one recurring theme: Grants will mean less money for the world's poorest.

Secretary Summers wrote in the *Financial Times*, "This would dramatically reduce the total amount of resources that can be brought to bear in these developing economies and require an unworkable system for delivering such assistance." World Bank President Wolfensohn in a letter to Commission Chairman Meltzer deemed grants "unrealistic" and went on to write, "In a time of severely constrained foreign aid budgets, it is highly doubtful that donors would be able to provide and sustain the needed level of funding."

Clearly the analysts at the Treasury and the World Bank have misunderstood the economics of grant financing and have ignored the potential of the private sector. A \$100 million World Bank loan does not require \$100 million in grants to achieve the same result. Every dollar of annual grants replaces \$17 of loans for the nations that need it most. The effective use of the \$133 billion in equity resources already at the World Bank will generate an annual grant stream of \$10.4 billion and support \$185 billion in aid programs or 78 percent more than is currently provided to the poorest nations. Each new appropriation will yield 140 percent of its dollar value.

The first question that has been asked is how do grants replace loans. The economics of the Commission's grant financing proposal permits the development banks to leverage resources by drawing upon the vast capacity of the private sector. The only true aid component of development assistance and the only cash requirement of this new format in a world of sophisticated financial markets is the small grant or subsidy that fills the gap between what impoverished recipients can afford to pay and the real cost of supplying the service. Under the Commission's proposal, this ranges from 90 percent of cost to 10 percent, depending upon the nation's per capita income and capital market access.

An example will clarify the grant-loan equivalency. A \$100 million, 20-year project can be financed through a traditional World Bank 20-year subsidized credit. This would require \$100 million of aid resources. This is the traditional approach development banks have taken in the past. Alternatively, the project could guarantee annual payments of \$13 million upon delivery of results. If the income level and capital market access of the recipient country qualify for 50 percent grant aid, the World Bank would enter into a direct contract to pay \$6.5 million per annum to the provider upon delivery of service. The recipient government would enter into a similar contract with the provider to pay the remaining \$6.5 million per year. The service provider would utilize the two contracts as security to obtain private sector funding. The financeable value of the direct World Bank revenue stream is \$59 million. The financeable value of the recipient country revenue stream is \$41 million. The reason for the difference is the different yields that the market would require on a direct contract with the World Bank compared to a contract with a recipient developing country. The private sector will provide the requisite \$100 million in funding with only a \$6.5 million per annum commitment of the World Bank.

This is how you achieve the leverage of \$6.5 million in annual development assistance providing \$100 million of development programs.

The key role here is the financing role of the private sector. Some may fear that the private sector will not provide the requisite resources because most truly poor countries are not creditworthy. This impediment is eliminated by the structure of the Commission's tools. The supplier is paid directly by the development bank upon independently verified delivery of service for its share of the cost. In the case of very poor countries with no capital market access, the direct payment obligation of the World Bank will equal 90 percent of total cost. A contract directly with the World Bank is eminently financeable in the private sector. The credit risk for the capital markets is therefore that of the service provider, which will be major international contractors or nongovernmental organizations, not the aid recipient. The favorable cost of this funding will be incorporated into the user fees on the project that is implemented.

As the income level or capital market access of the recipient nation increases, the share of the World Bank payment in total cost declines, but the ability to finance the recipient's obligations in the private sector rises.

The next question that has come up is where will the grant funding come from? The World Bank has \$133 billion in paid-in equity resources today. Paid-in capital and retained earnings on the Bank's balance sheet amount to \$29 billion, and IDA, its aid arm, holds \$104 billion in resources. If this endowment is invested in market investments at a conservative 8 percent return, an income of \$10.6 billion will be earned annually. After deducting \$200 million in administrative expense to run the aid program, the existing resources in the Bank will generate a stream of \$10.4 billion in annual grants in perpetuity.

The Commission has proposed two development bank tools: loans to promote institutional reform with subsidized interest rates based upon the Bank's own cost of financing, and grants covering a portion of user fees on infrastructure and social service projects. The extent of the interest and user fee subsidies varies between 10 and 90 percent based on the income level and capital market access of the recipient. The institutional reform loans would be funded through the issuance of debt secured by the Bank's investment portfolio.

The \$10.4 billion annual grant flow would be utilized to pay the interest subsidy on institutional reform loans and the user fee subsidy on infrastructure and social service projects. Utilizing the Bank's guideline of 25 percent of programs devoted to institutional reform, the grant

system under existing resources will support \$185 billion in aid programs for the world's poorest countries. This is 78 percent more than the current \$104 billion maximum under IDA's prevailing system of subsidized credits. The proposed structure has the additional benefit of reducing the Bank's capital at risk to the poorest countries by 55 percent because the endowment and grant revenue stream are unaffected by the financial condition of the recipients. This contrasts with the current system where the funds are totally lent out to the recipients, and if there are write-offs, such as proposed under HIPC legislation, or defaults, the resources are lost. The current level of IBRD non-aid lending can be maintained and supported by the callable capital of its industrialized members and a portion of the Bank's equity and investment portfolio.

The endowment would start at \$50 billion representing the IBRD equity capital and undisbursed funds at IDA. As each \$100 of existing IDA credits is repaid, instead of relending it, it would be added to the endowment. This would create investment income of \$8 for each \$100 repayment and provide grants that would leverage \$140 in development programs. Similarly, each new appropriation would increase the endowment and raise total aid programs by 140 percent of the new funds provided.

Any modifications of the assumptions underlying the analysis, including changes in financing rates, investment returns or amortization schedules, will not alter the basic results significantly.

From a financial standpoint, the Commission's proposal is straightforward. The proposal is making effective use of scarce development funds and of sophisticated financial markets.

In the appendix to my written statement, I have provided an analysis of the sources of World Bank income currently. In contrast to the Bank's public statements, its income does not arise from lending activities. Interest rates on loans only cover the Bank's borrowing costs plus administrative expense. There is no link between loans to middle-income countries and transfers to the poorest members. The Bank's net income is derived from two sources unrelated to its development mandate, the investment of its equity capital and donor funds and the profit from the reinvestment of borrowed funds in the market instruments. Thank you very much.

[The prepared statement of Dr. Lerrick appears in the Submissions for the Record on page 251.]

Representative Saxton. Thank you, Dr. Lerrick.

Dr. Calomiris, you may proceed.

**STATEMENT OF CHARLES CALOMIRIS, MEMBER,
INTERNATIONAL FINANCIAL INSTITUTION
ADVISORY COMMISSION**

Dr. Calomiris. Thank you, 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 information pertaining to the financial institutions' actual 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 in my words the rationale behind them, and responded to Secretary Summers' preliminary reaction 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 those recommendations, and I note that Dr. Lerrick's excellent presentation here today is a good step in that direction vis-a-vis the grant funding proposals.

I will not reiterate my previous testimony here today, but I am happy to answer any questions that you or members of the Committee may have on these various topics. I do, however, want to emphasize one point here today that received less attention in 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. Levinson, 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. Levinson in particular sees the multilateral agencies largely as vehicles of broadly defined American foreign policy.

Some observers might be forgiven for concluding from some of his remarks that he would use the IMF, WTO and development banks as tools to further protectionist interests of America's labor unions. I note, however, this is not what Mr. Levinson 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 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 congressional oversight consistent with the essential balance of power envisioned in 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 in three essential ways: First, by providing global public goods, for example, liquidity, the rule of law in international trade relations, and improvements in public health technology; second, by providing solutions to problems of negative externalities across countries, for example, pollution and economic instability that spills across national borders; and third, by offering an effective means for coordinating the global attack on poverty in the poorest countries.

These are sufficient challenges for the IMF, the development banks, the BIS (Bank for International Settlements) 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 their 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 under negotiation 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 will attach 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 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 (which doesn't exist) 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, and I repeat unless, those rules are necessary for the successful implementation of the narrowly defined economic objectives of the economic 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, reducing the abuse of IMF loans, 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 other 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. Levinson 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 underaged 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 support them. There may be examples in today's world that cross that line, but permitting starving 10-year-olds to work should not be sufficient to place a country on that black list.

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

[The prepared statement of Dr. Calomiris appears in the Submissions for the Record on page 261.]

Representative Saxton. Dr. Calomiris, thank you very much.

Mr. Levinson.

**STATEMENT OF JEROME LEVINSON, MEMBER,
INTERNATIONAL FINANCIAL INSTITUTION
ADVISORY COMMISSION**

Mr. Levinson. Thank you, Mr. Chairman. I do appreciate this opportunity to be here today. Let me begin by saying that at page five of my statement – and I will not read my statement in its entirety – I assume it becomes part of the record, so I will just deal with some of the highlights of what has been said today. I refer to the fact that my

separate dissenting statement should be available on the Commission website. I am informed that it is not and that the Chairman has not authorized it.

[The dissenting statement in question from the Commission's website appears in the Submissions for the Record on page 279; see also Dr. Meltzer's comments on page 35.]

Dr. Meltzer. That is not correct. It has been there for weeks.

Mr. Levinson. I am sorry. People have informed me, including staff members of this Committee, that they have not been able to access it and it has not been available. So if it is, then I am delighted, and I hope that in some way that that is a moot issue. Let's set that aside.

Now, Professor Calomiris has referred to my emphasis upon equity in the international economic system and the emphasis upon core worker rights and environmental conditions to be incorporated integrally into the World Trade Organization and to be a subject as well of the program conditionality of the World Bank and the IMF. There is no doubt that I do support that, and let me take this opportunity to set the record straight once and for all.

Professor Calomiris generously says that some people might conclude that my remarks – that I intend to use the IMF, WTO and development banks as tools to further the protectionist interests of American labor unions. However, he says that he notes that I disavow that intention. We all know that is a standard technique: You plant the seed as to what the intention is, and then you disavow believing that.

My father was a Teamster. He also had a chronic heart condition. He was in and out of hospitals. And to this day I can still hear him telling me that without the health plan that he got through the union, we would have been fiscally destitute. One day he did collapse at work, and he died of a heart attack; when the drivers who worked with him came to the house to pay their condolences to my mother, the shop steward for the union brought a \$500 check for burial costs, and my mother got \$10,000 from a life insurance policy which he could not otherwise have had except through the union.

I won a full tuition scholarship to Harvard. I got up at 5:30 in the morning to deliver the *Boston Globe* and the *Harvard Crimson* to the dorms, but I still could not have done it if I hadn't had some financial support from the family. That financial support was possible because of the fact that our medical costs were defrayed by the health plan that we

obtained through the Teamsters Union. So my support of core worker rights, including above all freedom of expression and collective bargaining, is a matter of conviction and personal experience. I make no apologies for my support of that, nor do I make any apologies for my work with the AFL-CIO on these issues and my writings in this connection. So let's be clear. There is no doubt I support core worker rights. It is based upon personal conviction, personal experience. I work with the AFL-CIO people. I have no apologies to make for that association.

The heart of the difference between us is precisely this issue of equity in the international system conceived as a system. If we step back and look at the World Trade Organization, we see a mature dispute settlement system for resolution of trade conflict. If we look at the NAFTA (North Atlantic Free Trade Agreement), we see a chapter 11 on investor rights, which gives the investor in the case of U.S. the right to bring a suit against a state, namely Mexico or Canada.

If we look at the multilateral financial institutions, the World Bank and the IMF, we see that they are intervening in the labor market for what is called labor market flexibility, which is a euphemism for requiring countries to adopt measures which make it easier to fire workers, weaken the capacity of trade unions to negotiate on behalf of their members, and drive down wages to gain competitive advantage. However, they disavow intervention for the purpose of addressing labor market abuses such as the use of the coercive power of the state to deny workers the right of free association and collective bargaining. That, they say, is political.

It escapes me as to how intervention for the purpose of driving down wages and weakening trade unions is not political, but intervention for the purpose of protecting core worker rights is political. I think that position, frankly, is nonsense.

So the difference between us is that in my separate dissenting statement and in my statement today, I emphasize this question of the lack of equity in the system, the imbalance in the system. You would never know from reading the Majority Report that the Commission took any testimony on this issue. As I note in my prepared statement today, there was extensive testimony, but the issue isn't even addressed in the Majority opinion.

We heard this morning Professor Meltzer say that countries that don't meet the preconditions could still borrow at steep penalty rates of interest. If you look at page 43 of the Majority Report, they state, except

in unusual circumstances, here I am quoting, where the crisis poses a threat to the global economy, loans would be only to countries in crisis that have preconditions that establish financial soundness.

Now, if you turn to page 44, you will see that – I am sorry, page 46. The new rules should be phased in over a period of three to five years. If a crisis occurs before the new rules are in place in most countries, countries should be permitted to borrow at an interest rate above the penalty rate. The superpenalty rate would give countries an additional incentive to adopt the new rules. So the ability to borrow at the superpenalty rate is for the transition period, but once you get to a steady state past the transition period, then we revert to the statement at page 43, which says that only countries that meet the preconditions are eligible for financing.

And this goes to one of the issues that Professor Calomiris addressed at the end of his statement, which is the egregious abuser of human rights. Under their criteria, as long as you meet the financial criteria, you automatically qualify. Professor Calomiris may have made that statement in the hearings about egregious abuses on human rights not being eligible, but that is not part of the Commission's Majority recommendation. Access to the resources of the IMF are automatic once you meet the financial criteria.

At page 44 they say the IMF would not be authorized to negotiate policy reforms. And they go on to say the policies necessary to improve economic performance and end a crisis are well known. Let's take the East Asia crisis as an example. There are four possible explanations for the crisis in East Asia in 1997: First, that it was the result of the pressure from the United States authorities, in particular our administration, to open capital markets before the countries had institutions in place to regulate and discriminate among institutions that were borrowing abroad. That intervention is described in exquisite detail, quite frankly, in a remarkable article by David Sanger and Nicholas Kristoff of February 16, 1999, "How U.S. Wooed Asia to Let Cash Flow In." If you read this article, the overwhelming impression is that the origin of the Asian crisis was pressure to prematurely liberalize capital markets. They summarize the roster of culprits as follows: Responsibility can be assigned all around – here I am quoting – not only to Washington policymakers, but also to the officials and bankers in emerging market countries who created the mess, to Western bankers and investors who blindly handed them money, to Western officials who hailed free capital flows and neglected to make

them safer, to Western scholars and journalists who wrote paeans to emerging markets in the Asian century, end quote. You notice who is absent from this roster? Workers. But they are the ones who paid the primary price.

Now let me just conclude by the three other explanations since I see the red light is on. The other primary explanation is that it was a purely financial crisis, a classic financial panic. That is set forth by Professor Sachs, another member of the Commission, in his article in the *American Prospect*. He says, by making it into a structural issue, short-hand known as crony capitalism, the IMF worsened the crisis by convincing investors that something was fundamentally wrong, when what you had was a classic financial panic.

The third explanation is the structural issue, and that is the one that underlies the Majority's recommendation for preconditions, that the problem was the crony capitalism, the close relationships among banks, government and corporate officials, and in that they joined with Mr. Fischer, Managing Director of the IMF, in the IMF analysis.

And the fourth explanation is moral hazard, that the bailout of Mexico led to the bailout and the imprudent lending by the banks in the east Asian countries, which I think is totally without support.

The more plausible explanation is that the banks in Japan and Western Europe, faced with recessionary conditions in both areas, looked for more profitable outlets, and as occurred in the decade of the 1970s, they placed them where they thought they could get the better rate of return, and, if you will recall, that was the decade of the Asian tigers, the great attraction of the east Asian countries.

So it is not at all clear, as the Majority says, that the analysis of the origin of the crisis is self-evident to everyone. In the east Asian crisis, there are at least four explanations, none of which are necessarily mutually exclusive, but if you take one as the primary explanation, that leads to a different conclusion as to what your remedy is. It is not at all clear, as the Majority says at page 44, that the policies are self-evident.

I would just leave the conclusion at this point that the major point of difference, then, is they take no account of the legitimacy of the issue of core worker rights and the environment as an integral part of the international system. They preclude the IMF from addressing through policy the underlying conditions that led to the crisis, and that is where the primary differences lay. I can go into detail as to why what Dr. Lerrick

outlined is really patently absurd as a mechanism, et cetera, but I will leave that aside.

[The prepared statement of Mr. Levinson appears in the Submissions for the Record on page 267; the IFIAC's Report appears on page 69.]

Representative Saxton. Thank you very much.

My observations over the past several years have led me to believe that there are at least five issues that I would like to explore, which I believe are critical to this discussion. They are, first, the role of the United States in the IMF and the contribution that we make; second, the terms of the loans, that is, the length of the loans which we have described as primarily development loans; third, the subject of subsidized interest rates; fourth, the subject of interest rates that are actually charged to borrowers through the IMF; and fifth, the need for transparency.

So let me just ask a question about each of those and permit you to respond, and I will do this as quickly as possible, but I think these are five issues that really need to be discussed in some depth.

One of the issues that I raised in 1998 related to the IMF development lending, or the length of the loans, and the impact of the Fund's ability to act as a crisis lender. Both the Treasury and the Meltzer Commission are on record supporting a deemphasis of the IMF development lending. Although there are some differences about how much of this development lending activity should be deemphasized, this basic premise seems to be accepted, and I think that is good news.

Could you, Dr. Meltzer, begin by explaining to us from your perspective how development lending – what impact development lending has on IMF operations generally?

Dr. Meltzer. Development lending, in my judgment, and I believe in yours, should not be a part of IMF operations. This mixes roles. The IMF has an important role. That important role is to prevent liquidity crises that disrupt international financial markets and disturb the international economy; and second, to provide and disperse information.

Now, development lending – none of those functions require the IMF to be involved in development lending. In the interests of accountability and transparency, it is very good to have people be responsible; that is, the IMF be responsible for its sphere of activities. Development lending would be the responsibility of the World Bank and the other regional development banks. We certainly are in favor of development lending provided it is made – as the World Bank's research has shown, provided

it is made for purposes that are going to be successful, not just to sprinkle money around the world, but to see that we actually have programs that lift countries out of poverty. And our criticism of the World Bank is that while their rhetoric on these issues is superb, their actual accomplishments are somewhat less than good.

Representative Saxton. Mr. Levinson made, I think, a great point when he said occasionally individuals and countries have an immediate urgent need for help, as in the passing of his father. When the IMF was established, it was established, from my understanding, for purposes of liquidity crisis lending, which is a short-term need that occurs and help is needed right away. Now, does long-term development lending in any way inhibit the IMF's ability to make these shorter-term loans?

Dr. Meltzer. In my judgment, no, it does not inhibit. In fact, the more they interfere and become involved in all sorts of other issues, the more that they sacrifice and become a multi-objective institution where they have to balance one objective against another. What they ought to be doing is doing their job and doing it better than they have been doing it.

Representative Saxton. Could the IMF's multi-year development programs reduce its available resources and ability to act in unexpected crises?

Dr. Meltzer. That is one of the ways that the conflict comes about. The IMF has a limited amount of resources. It could increase those resources, as you have suggested and your staff, by borrowing, but it has elected not to do that. So, yes, there is a limit on its resources, and the more it puts into development aid, the less likely it is going to have – the more likely it is going to have to come back to the Congress and the other Parliaments to ask for more money. But in a particular crisis it may find itself with insufficient funds. If we could get their balance sheets and income statements straightened out, we could make more clear statements about how much funding they have.

Mr. Levinson. Mr. Chairman, might I intervene at this point to comment on your comment and—

Representative Saxton. Sure.

Mr. Levinson. I think you have to put this issue of the IMF's – what appears to be development lending in some perspective. It really derived from the oil crisis of the 1970s, the Witteveen facility, the feeling that with the oil crisis the perception that the IMF had to make resources available on a longer-term basis to the countries than the conventional one

to three years, because the oil crisis had created a qualitatively different situation. That was the origin of the Witteveen facility in 1977. That led to the expansion of the terms of IMF loans.

The problem of development lending, when it spills over from the short-term addressing of the problem that led to the liquidity crisis, leads you into this issue of what was the cause of the crisis. If you believe, as Chairman Meltzer, Professor Calomiris, and Stanley Fischer and the IMF staff, that the cause of the crisis in east Asia was primarily crony capitalism, shorthand for the improvident banking systems of those times, then the IMF says, well, of course, if that is the cause of the crisis there, we would be remiss if we didn't address that as part of our attempt to meet the short-term crisis. You would be criticizing us on that count if we didn't address that.

If your view is that it was a purely financial panic, as was Professor Sach's view, or that it primarily was the consequence of premature capital liberalization as the Kristoff and Sanger article implies, then you come out with a completely different situation. The IMF does not plunge into structural reform. You can't avoid deciding what is the basis of your analysis of what led to the crisis in the first place. That is the problem that their proposal leads to, because since it is only – since the IMF funding is only limited to countries which prequalify, you are precluded from addressing the underlying issues which may have led the country into the crisis.

Dr. Meltzer. May I interrupt just to say, sir, there is a role for the World Bank and the development banks. If there are long-term structural adjustments, we address those issues in great detail in our Report, come up with a mechanism for dealing with long-term structural adjustment problems and institutional reform. That has nothing to do with the question about – that just obfuscates what is an important issue, and that is how do we make the world safer, more secure, much less subject to risks than it is at present. That is one question. The second question is how do we help people out of poverty? There is no reason why those two questions have to be joined, and it simply obscures matters to join them.

Representative Saxton. Isn't it true – and I know Dr. Lerrick wants to say something – but isn't it true that, going along with what you just said, that when the IMF came to the United States in 1998 and requested and got \$18 billion additional, it then came back with a proposal to sell gold in broad terms? Isn't it true that those activities and actions on

the part of the Congress were necessary because the IMF had developed a need for additional funds, and they developed, at least in large part, a need for additional funds because of long-term development lending which didn't previously occur?

Dr. Meltzer. Yes. There are two separate issues there. One was to – to oversimplify, but not oversimplify greatly, the great drain on IMF resources was, of course, the assistance to Russia and the possibility that I think people recognized at the time that there might be a breakdown in the Chinese banking system that would create also a need for substantial additional funds. So rather than to meet those issues directly, like the question about aid to Russia, and come to the Congress and ask for an appropriation to assist Russia in its transition, the Administration presents you with the IMF as a source of that money and try to cover over the fact, or at least to obscure the question about why they need the money.

Now, the money was needed because they are in the development lending business, in the transitional lending business. In my judgment, and, I believe, in the judgment of many of the people at the IMF privately, they should never have been in that business. They didn't know anything about the business when they got into it. They avoided for a very long time doing the things that were necessary to make the transition succeed like suggesting to these countries that they impose the rule of law and such other things. They saw the problem. It is really a clear case of what Mr. Levinson is complaining about: They saw the problem initially as purely financial, and it wasn't – as a purely financial problem. That was the problem that the World Bank – if there was going to be an international lender – should have done or was a problem that the G-7 more likely should have done, but it was not a problem that the IMF should have handled. It wasn't well equipped to do it, and I believe it was a mistake to get them involved, and it is a mistake to keep them involved.

Representative Saxton. Dr. Lerrick?

Dr. Lerrick. Mr. Chairman, very briefly, Mr. Levinson's comments are confusing a relatively straightforward issue. What the Commission has proposed is the division of responsibility between the IMF and the development banks. Now, if you have a crisis, whatever its origin – it may be structural or financial, it may be purely from an external shock – the Fund's job is to provide temporary liquidity during a short period of up to 240 days up to one year, let's say, as an arbitrary benchmark. If it is truly a financial crisis, the Fund's role is to address it by providing liquidity to the system. At the end of three weeks, a month, two months, you will

know whether it is purely a financial crisis because then the country will stabilize and not require additional resources. If it is a structural crisis, then the problems will persist.

What the Fund's job is, is to provide liquidity for a period of time so the country can come up with a structural reform program and obtain long-term financing to enact that program either from the private capital markets, such as Colombia did in 1985 without any Fund assistance, or from the development banks through a loan program to enact those structural reforms and finance them. So the source of the crisis does not affect how the Fund should provide assistance.

Representative Saxton. We are going to have to move along here. That was the first of five questions that I thought I was going to ask in five minutes. Those of you who have not dealt with this on a steady basis as some of us here are getting an idea of how complex some of these issues are.

In the sense of fairness, I would like to go to Mr. Stark. I have four more questions. One is relative to the role of the U.S., one is relative to the subsidized interest rates, one is relative to the interest rate charged to borrowers, and, finally, the need for transparency.

Mr. Stark, it is your turn, sir.

Representative Stark. Thank you, Mr. Chairman. I will be brief. I would rather be out protesting, I think, with my friends out on Pennsylvania Avenue than listening to this kind of rarified elitist group. But the first statement is that while we have been waiting for the completion of the testimony, our staff went out – and I admit, Dr. Meltzer, to being technically challenged, but I am dammed if we can find the Minority Reports on your webpage. So I challenge you, if you could find them, print them out—

Dr. Meltzer. I would be glad to do that. I should point out to you, Mr. Stark, that it is no longer my webpage. It is the property of the U.S. Treasury. They assured me that those were put there.

Representative Stark. Well, they have hidden it so the people with thick fingers like myself can't find it. Any assistance you can give us on finding it would add immeasurably to your credibility.

[A printed copy of the dissenting view from the IFIAC's website appears in the Submissions for the Record on page 279; see also Dr. Meltzer's comments on page 35.]

Dr. Meltzer. May I respond to that just very briefly?

Representative Stark. It is either there or not there, Doctor.

Dr. Meltzer. May I just say that one reason it was delayed in getting there was because none of the members of the Minority chose to send the copies of the report to me. They chose to send them elsewhere, but not to me. When it was called to my attention—

Representative Stark. I am not here to arbitrate squabbings.

Dr. Meltzer. I just want to let you know that I absolve myself from responsibility for that.

Representative Stark. I haven't been troubled with academic squabbles for a great number of years, Doctor, and I would rather not start again.

I am concerned that the IMF seems to be more concerned with problems of bankers – which I was once – and not very much with the problems of the poor in the world, as seems to be well-documented in testimony before us this morning. And if indeed it is determined by the Majority that you ought not to be criticized and ought not to make decisions about financing various countries based on political decisions, then I guess it goes down to us. If at some point we can get the votes to do as you would do to some countries – that is cut off their money – that sounds like a good alternative to me. I am dammed if I can figure out with all that I hear this morning what you all have done in the world except help those that don't need any help. That is not at least why I labor in this vineyard.

It seems to me the Commission's recommendations, at least in the Majority, deal only with banking requirements. And you suggest that – for instance, in environmental protection – that you should concentrate on the production of global goods. Dr. Meltzer, you say it should include the rational protection of environmental resources. I would challenge you – not now, because I have limited time – to give me a memo on irrational environmental protection. I presume that would be emotional and other kinds, but I would like some examples there.

[Chairman Meltzer's written response to Representative Stark appears in the Submissions for the Record on page 278.]

As to labor standards I never was in a union, but I have a father-in-law who was a Teamster, and if I ever voted against the unions, he would break my leg. And I seem to recognize that as enough

influence. But putting Frank with a high school education up against Dr. Calomiris would be tough. Now, my father-in-law was on strike with the Teamsters in Oakland back many years ago, and my wife tells me that they went six or nine months with Hamburger Helper and splitting a little can of tuna four ways. This was when she was in kindergarten, and she would never cross a picket line, remembering that. But, of course, Dr. Calomiris would have put her to work in kindergarten delivering papers or doing something like Mr. Levinson did.

I am just troubled – do you have children, Dr. Calomiris?

Dr. Calomiris. Congressman, I have two daughters. I suggest you leave them out of the discussion.

Representative Stark. Good. In your academic background – you have a doctorate; I presume it is not an M.D. Do you know who Jonathan Swift was? Did you ever read *A Modest Proposal*? Seriously, did you ever read it? Do you know what it is?

Dr. Calomiris. Many years ago I think I did read it, Congressman.

Representative Stark. It sounds just like you. Go back and read it, and it will bring joy to your hard hearts. Jonathan Swift and you had the same idea permitting starving 10-year-olds to work. I think it takes you back, you and the Heritage Foundation, back to the 1800s where your ideas may have had some credence. But to bring that baloney to us in a free world with people starving, and our fight now is whether to bring all of this wonderful help to China who enslaves children and not give it to Cuba who somehow people have decided is worse than China, eludes me.

My question is why we put up with this nonsense from the IMF and the World Bank and why we as a democratic country continue to support it. That is my question, Mr. Chairman.

Dr. Meltzer. Are these questions addressed to us or—

Representative Stark. To Mr. Levinson to start. He makes more sense than any of you, and then you can go down the table.

Representative Saxton. If the Chair may, I would just like to let Dr. Calomiris respond first.

Dr. Calomiris. Thank you very much.

Mr. Stark, I have no interest in seeing children, particularly poor children, work. That is not something that I would like to see. I would certainly embrace proposals that you might want to propose or others

might want to propose for us as a country to undertake more economic responsibility to make that unnecessary. However, let me—

Representative Stark. How about making it illegal?

Dr. Calomiris. Let me make it very clear, that if you make it illegal for them to work, but do not simultaneously do other things that enable them to continue to survive, you are behaving immorally, sir.

Representative Stark. Bingo. What have you done in this la-di-da group that you belong to to help any of the poor children in China, for example?

Dr. Calomiris. We have proposed, sir, substantial increases in poverty alleviation programs by the development banks, for example.

Representative Saxton. Mr. Levinson.

Representative Stark. That is laughable on its face.

Mr. Levinson. It is difficult to know where to begin, but to begin with, Mr. Stark, I would not put my name to this Majority Report under any circumstances because it is so partial, it is so incomplete and one-sided and so biased that under no circumstances would I sign it. I was sorely tempted to vote with three members of the Commission who wanted to abolish the institutions altogether, because it is so difficult to get them to move off of it. The culture of the institution is so wedded to this neoclassical economic vision which sees any government intervention as undesirable, including labor standards.

What are we talking about with respect to labor standards? We are talking about the most basic rights, freedom of association and collective bargaining so that workers can engage in free trade unions and then negotiate what is appropriate in their own circumstances in terms of wages, benefits. It is the labor unions in places like Brazil that have been in the forefront of agrarian reform and addressing the child labor issues. I know of nobody that has been addressing the child labor abuses who doesn't couple measures to address those issues with complementary measures to provide financing for education and for the families so that the children can be withdrawn from the labor force without economic detriment.

It is a false dichotomy to say you are for one or the other. The Majority simply refuse to address and object to the incorporation of these core worker rights as they were defined by the AFL-CIO people in

testimony. Freedom of association and collective bargaining, the Majority want no part of that as part of the international economic system.

Representative Saxton. Thank you very much, Mr. Levinson.

Dr. Meltzer. I would like to take up the issue with Mr. Stark. I first would like to ask you a question, sir. Have you read the Report?

Representative Stark. No, I haven't read the Report, Dr. Meltzer

Dr. Meltzer. You can't possibly make some of your statements if you had read the Report—

Representative Stark. Oh, yes, I could. But all you have to do is listen to the palaver you have brought here this morning, and that is basis enough. I have never heard such arrogant, insufferable nonsense.

Dr. Meltzer. May I respond to your statement? That issue came up at the very beginning. I had a meeting with Mr. Levinson. As a result of that meeting, or as partly as a result of that meeting and other discussions I had, I met with a member of the Democratic Minority. He told me at the time, as Mr. Levinson had told me, that members of the Democratic Minority, or certainly large parts of the Democratic Minority, would not read the Report, accept the Report, have anything to do with the Report if it didn't have core labor standards. I pointed out to them—

Representative Stark. How about environmental protection?

Representative Saxton. Let him finish, please.

Dr. Meltzer. Let me just say at that time I told them what I will now say to you. It is not an arrogant statement, it is a statement of fact. I told them as far as this Commission was concerned, first, it didn't seem to be within our jurisdiction, but even if we extended our jurisdiction, it was not true that even if I favored core labor standards, it would not be true of either the Majority or the Democratic Minority appointed to the Commission that we would approve core labor standards. There was no chance in that Commission at all.

I explained that at the time to a member of the Minority Party – I would be happy to tell you his name, but I don't want to quote him without his being here – that that really is the sum and substance of the issue. If it had been brought to the Commission, it would have been voted down. The Majority was not in favor of it, neither the Majority appointed by the Republicans nor the Minority appointed by the Democrats.

So to say that we didn't consider it, we did discuss it. Mr. Levinson himself talks about the issue. We didn't put it in the Report because it did

not seem to me useful to say that we were against it. It was not within our jurisdiction, and so we simply avoided the issue. That is the sum and substance of the issue. You may not like that result, but as I explained earlier when I discussed this issue with other members of your party, that you are not going to take our Report and enact it into law verbatim. You are going to look at it.

If the Congress wants to discuss core labor standards, certainly that is within their prerogatives. That has very little to do with the financial reforms. There are pressing financial reforms that need to be done. We need to improve the poverty programs of the world. The World Bank has wonderful rhetoric, but very poor performance.

Representative Stark. No performance and lots of rhetoric.

Representative Saxton. The gentleman's time has expired.

We are going to move on to Mr. Sanford.

Representative Sanford. I would just say that this is getting a little spicy for my taste. It feels more like a Judiciary Committee rather than something as analytical as a Joint Economic Committee.

I would want to disassociate myself from the line of questioning or reasoning of my colleague from California because I think that legitimately we can have strong policy disagreements on all kinds of different things, but to pull in a witness's kids and how many kids he has, to me, is very irrelevant.

First question, Dr. Meltzer, rate of return for World Bank. Are there any estimates as to the overall rate of return for the World Bank?

Dr. Meltzer. On its loans? On its loans, it charges – it receives a rate equal to the rate at which it borrows, plus usually a half of percent premium that it charges for administrative fees. So its rate of return – if it borrows at 6 percent, its rate of return on the loan is 6-1/2 percent and so on.

Representative Sanford. But that could include the default rate; in other words, probably a negative rate of return if you include default or restructuring, et cetera?

Dr. Meltzer. I don't know the answer to that question. I would guess that the answer is not a negative rate of return overall.

Dr. Lerrick. Mr. Sanford, when the World Bank lends money, it just takes its pure borrowing costs. In Dr. Meltzer's example, it issues a bond at 6 percent, and it then adds on a small margin of between .25 and

.5 percent to cover its administrative expenses, which are just out-of-pocket expenses. That is the lending rate.

Now, it does provision for loan losses, but that does not come from its lending activities. It comes from its net income, and its net income is unrelated to its lending activities. For instance, the World Bank has \$29 billion of equity capital on which it pays no interest or dividends. Just the investment of these funds at 6 or 7 percent generates close to \$2 billion a year in net income. That is how they provision for loan losses. They do have reserves on their balance sheet of a number of billions of dollars.

Representative Sanford. So, the blended rate – in other words, if you include the cost of capital from the taxpayer to the World Bank in the initial setup, the blended, in essence, rate would be negative?

Dr. Lerrick. Well, if you include the taxpayers' cost of funds, then it would be negative, yes.

Representative Sanford. So I guess what I am getting at is oftentimes I hear with these types of organizations that, quote, we cost the taxpayer nothing. I hear that as almost a consistent refrain. That is probably not really true if you look at cost of capital in a total sense.

Dr. Lerrick. Mr. Sanford, that is absolutely not true. If you look at the Commission Report, there is an estimate of the cost of the development banks to the membership each year. It is approximately \$22 billion per year.

Dr. Meltzer. About \$5 billion to the United States.

Representative Sanford. But it is generally thrown out?

Dr. Lerrick. All of the IFIs (International Financial Institutions) claim that their costs to the donor country taxpayers are zero. For instance, in the Commission's Report there is an analysis of what the cost of the multilateral development banks is, and the total cost to members is approximately \$22 billion per annum. The share of the cost of the United States is approximately \$5 billion per annum.

Mr. Levinson. That is like comparing apples and oranges, frankly, Mr. Sanford.

Representative Sanford. Why do you say that?

Mr. Levinson. Of course, you can get a high rate of return if you alternatively use some money by looking for commercial—

Representative Sanford. Let's come back to that. I want to go down a particular line of thought with that.

The second is tied to subsidized rates, which is if you consider the risk profile of whether an IMF or World Bank – if you consider the risk premium that a normal commercial enterprise would charge in that environment we do have a subsidized rate; is that not correct?

Dr. Meltzer. That is correct, yes.

Dr. Lerrick. Of approximately 7 percent per annum.

Representative Sanford. Where I am going to with this is—

Dr. Lerrick. On interest-bearing loans. On the loans that are going through IDA which have zero interest in essence the subsidy is 15 to 20 percent per annum.

Representative Sanford. So we have something that costs the American taxpayer about \$5 billion. We have something where a taxpayer in America is subsidizing, in essence, development in other parts of the world to the exclusion of development maybe in their own county or their own home State; is that not correct? In other words, if you subsidize – in other words, you would encourage one to build a plant in Turkey, for instance, as opposed to building the same plant in Memphis, Tennessee, given the fact that the rate may differ via a World Bank loan; is that correct?

Dr. Meltzer. That is correct, they are subsidizing.

Representative Sanford. Then my question is why couldn't a lot of this activity simply be handled through commercial banks as opposed to World Bank and as opposed to the IMF?

Dr. Meltzer. That is the Majority recommendation, that the IMF – that is one that has drawn many of the sparks – that the World Bank and other lending be taken out of China and other countries where they can borrow in the capital markets and that this aid and assistance be given principally – in fact, exclusively to countries which are poor and cannot borrow on the capital markets. So we do take up that issue. In fact, we have been severely criticized, I think incorrectly, because it is the number of poor people in the world without resources that we want to help.

Dr. Lerrick. Mr. Sanford, the development banks portray themselves as lending to countries that don't have access to private sector capital and to projects that are of no interest to the private sector, in essence saying that the private sector lends 80 percent of what it provides to 12 countries, whereas the development banks lend to the world. The fact is that 11 countries account for 70 percent of World Bank lending,

and those countries include – China, Argentina, Mexico, Indonesia, Korea, Brazil, the Philippines, Turkey; the list of usual suspects and the same countries you are talking about in private sector lending.

Representative Sanford. Mr. Levinson, I cut you off. I wanted to go down—

Representative Saxton. Your time has actually expired. Could you wrap up in the next minute or so, please.

Representative Sanford. I will let you do so, the last minute, yes, sir.

Mr. Levinson. I think that the testimony, if you will pardon me, is misleading. They continually refer to World Bank. First they propose that the World Bank divest itself of any operations in Asia and Africa, so what you have done then is turn the World Bank into a super development agency for Africa, then only until the African development bank can take over, in which case it then becomes something that deals with what they call public goods, solving the problem of malaria and HIV in Africa – I don't know why anyone could believe that the World Bank is going to do any better than the World Health Organization – or that it becomes the coordinating agency for other NGOs, so you really don't have the World Bank as an alternative.

Representative Sanford. Your counterpoint to that would be what, sir?

Dr. Lerrick. That is a different issue. There are two distinct issues. One is what should each institution have as its responsibility, and the second issue is where should these institutions as a group be lending their money. They are totally separate questions. The Commission has assigned global public goods and transnational projects to the World Bank. That has nothing to do with whether you want the development banks, as a group, to be sending resources to China and Argentina or not.

Dr. Meltzer. Mr. Chairman, may I interrupt just one moment to say that the staff has just handed me a copy. I would like to respond to Mr. Stark's question of my integrity.

Representative Sanford. Let's do that on somebody else's time. I have 30 seconds, and coming back to you—

Dr. Calomiris. I just wanted to clarify, because Mr. Levinson asked why the World Bank should be involved in this rather than the WHO (World Health Organization). In our deliberations we identified

financial aspects of promoting the public goods of global health where the World Bank would play a role. So we do believe that it does have a role to play here.

Representative Saxton. We are going to proceed to go to Mrs. Maloney now.

Before we do that, Dr. Meltzer, would you like to take 30 seconds?

Dr. Meltzer. Yes. I have here – Mr. Frenze just gave me a copy of the Report by Mr. Levinson which was downloaded from the website. I believe that the location on the Web site is as part of the Commission Report; that is, that it is there as part of the whole Commission Report. We have been sent – I must say we sent out something like 3,000 copies of this Report. So we have not been negligent about trying to produce it. I am really sorry that you question my integrity about this because—

Representative Stark. I merely questioned my ability to find it, Doctor, and I am —

Representative Saxton. It must be your computer skills.

Dr. Meltzer. If you download the Report and read the Majority Report, you will find the Minority Report.

[A printed copy of the dissenting view from the IFIAC's website appears in the Submissions for the Record on page 279.]

Representative Saxton. Mrs. Maloney, proceed, please.

OPENING STATEMENT OF REPRESENTATIVE CAROLYN B. MALONEY

Representative Maloney. Thank you, Mr. Chairman, for focusing on the important issue of international financial institution reform. I would like to begin by saying that I do believe there should be some reforms to the IMF. I agree with my colleagues who said earlier that we can have honest policy debates and disagreements, but really the bottom line is when there is a financial crisis, it is people that suffer, particularly in the world's poorest countries.

As a member of the Banking Committee, earlier in a bipartisan way Chairman Leach and Ranking Member LaFalce voted to provide a debt relief for the world's poorest countries at the end of last year. Chairman Leach gave a strong statement, and I quote, "Relieving the debt burdens of the world's poorest countries is one of the foremost economic, humanitarian, and moral challenges of our time," end quote.

I look forward to the debate as it goes forward on the reform of the IMF, but one thing that I urge all of my colleagues in a bipartisan spirit is not to use HIPC (Heavily Indebted Poor Countries) relief legislation as a vehicle for IMF reform. I believe that, as one of the principles of the Meltzer Commission Report, that additional debt relief for desperately poor countries must not be delayed, tied up, or hindered in any way by efforts to move forward reforms of the IMF and World Bank. As the world's wealthiest and most influential Nation, our actions will set the standard for additional HIPC reform and relief in the country.

Secondly, under the debate for international financial institutions, in some areas there is broad agreement. And all sides, I believe, agree that private capital is the preferred way to address international financial problems, and when situations require the relief or assistance of IFIs, their operation should be transparent and accountable. And the arrival of the IFI Commission Report, I want to note, does not mark the beginning of efforts to really reform these entities. The administration is already leading the world in its efforts to modernize IFIs. Treasury is already working to refocus the IMF to lend on shorter maturities, and Secretary Summers has already stated before the Banking Committee and publicly that the World Bank should focus on lending to projects that would otherwise go unfunded by the private sector. So I welcome this Commission Report and its debate.

I would like to begin by asking Mr. Levinson and then anyone who would like to comment, can you discuss the dangers that the spreading of the Asian financial crisis, the so-called Asian contagion, presented to the United States, especially to small investors and mutual fund investors? I like to ask – and I remember it did not turn into a great problem, but there was tremendous fear in our financial markets during the Asian crisis. I would like to ask if the recommendations of the IFI Commission had been enacted in 1998, would the countries that received IMF aid have been eligible? And what would the impact have been on the ability of the IFIs and leaders like Larry Summers and others to react to and find the contagion?

Mr. Levinson. I think the impact would have been major, that most of the countries who were helped as part of the East Asian rescue would not have been eligible for IMF financing if the Commission recommendations had been in place. And with respect to contagion, I think Mr. Fischer testified to that and said that the reason that he felt that the IMF intervention was necessary was that otherwise there would have

been significant ripple effects which would have meant an even deeper decline in the economic development activities of these countries; it would then have impacted on our own economy and have continued for a longer period of time.

That, of course, gets to the heart of the issue. South Korea was organized on a completely different set of principles. They followed the Japanese model of directed credit. If Korea had not made the complete transformation to the kind of criteria that they outline as the necessary preconditions, they wouldn't have been eligible for IMF financing. Remember, on page 44 of their Report they say the IMF is prohibited from negotiating a program with a country in difficulty. If you don't prequalify – Brazil, for example, now has imposed some limits on foreign banking because they are concerned, about foreign domination of their banking sector. They have a strong domestic banking system. Under the Majority criteria, Brazil would not be eligible. But Brazil has sufficient weight in the economy that it may have major ripple effects throughout Latin America. Th criteria are too rigid.

The other thing Fischer noted – an admittedly extreme example – he said that Nazi Germany would not be eligible for financing on political grounds. Under their criteria, if you qualify under the purely financial criteria, you are eligible. No other considerations can be taken into account.

So it is much too rigid. It is risky in terms of the effects upon our own domestic economy because it is such a straightjacket, and I frankly think it would be disastrous.

Dr. Meltzer. May I respond to that briefly?

Representative Saxton. The gentlelady's time has expired, but Dr. Calomiris has been coming out of his seat trying to respond to something that Mr. Levinson said.

Representative Maloney. Also, could Dr. Meltzer respond, too, if he wishes?

Representative Saxton. The problem is we have 20 minutes to go before we have to vacate the room, and so I am trying to move through as much subject matter here as quickly as possible.

Dr. Calomiris. I will really try to be fast. Let me try to respond to your question. The answer has three parts. First of all, keep in mind that we envision a phase-in of five years. The right way to ask your question, if I may, is if these recommendations had been passed in 1992, then how

would that have affected the Asian countries in 1997? May I answer that question that way? Because the point is that if these recommendations are to be phased in, then if we had passed these recommendations even in 1997, they wouldn't have been phased in for five years, so things would have just proceeded more or less as they did.

Now, if the policies had been put in place in 1992 and phased in by 1997, suppose that Korea had qualified. And they might have because of the powerful incentives that Dr. Meltzer talked about for trying to qualify. Well, then, I think that the liquidity available would have been allowed, and the problems in the banking system would have been much less. Suppose they didn't qualify? We still then would allow at the discretion of the IMF, then waiving of the prequalification requirement, but lending at a superpenalty rate, which they could have done.

Now, here is something that Mr. Levinson missed. If you actually look at the flows of funds that went to the Asian countries by the IMF, not the flows that were promised, but the flows that actually went, they were quite small relative to what was promised. There was very little actual liquidity assistance provided by the IMF to those countries, but there were rigid fiscal requirements which Mr. Stiglitz and others have criticized which did affect those economies.

Under our standards, which would not have required the fiscal melt-down in those countries that the IMF imposed, and which would have made funds available on a much larger basis immediately as liquidity protection, that those countries would have fared much better, even if they hadn't prequalified, than they did under the IMF's programs.

Finally, just to note we never said that every country in the world should be an IMF member. We were attaching prequalification requirements and lending rules to IMF members. I think Mr. Levinson raises an interesting question of who should be allowed to join the IMF. We never dealt with that question. He never made a recommendation that we deal with that question that I can remember, and if he did, I think it is a reasonable question, and I support his view that the IMF shouldn't be available to Nazi Germany.

Dr. Meltzer. I will be very brief. I want to thank you, Mrs. Maloney, for your interest in these issues. They are very important issues from the standpoint of the United States.

Three major reasons why crises have been deep and severe: One is pegged exchange rates collapse; the second is financial systems

collapse; and the third one is it takes a long time to negotiate the 40, 50, 60 terms that the IMF imposes on these countries. Our Report says get rid of pegged exchange rates, strengthen the financial systems, make the rate of lending automatic so that it would come quickly. Then the crisis would not have occurred if these things had been in place. Dr. Calomiris has spoken to that, so I won't repeat it.

Let me say also, bear in mind that countries that did not get IMF assistance, that rejected IMF assistance – Malaysia – they recovered as fast and as well as many of the countries that received that assistance. So the assistance came, the big assistance came, because the U.S. became the sink for exports from those countries. That was the proper policy for the United States to follow at the time, but it isn't a good long-run strategy for the U.S. to follow. If we don't deal with the crisis, we are going to be in a position of absorbing those exports all the time to bail them out. Our Report tries to say, let's get rid of the problem, and then we won't be the sink for exports that no one else is willing to take.

Representative Saxton. Thank you very much.

Let me get back to my line of questioning. I indicated that I thought, first of all, I, as the Chairman and now the Vice Chairman of this Joint Committee, have worked with our staff hard and, I might say, tirelessly trying to bring about certain reforms to the IMF which I think are necessary, and I am delighted that it appears there are four or five measures that we have been working for that both the Treasury and your Commission and I tend to agree on.

We talked about the length of terms of loans during the first round of questioning. During this series of questions I would like to talk about the issue that Mr. Sanford brought up, subsidized loans, and then the need for transparency, and then the role, and the important role, the United States plays in bringing about these decisions at the IMF.

First of all, what is the average rate that the IMF charges on its loans? Dr. Meltzer, what is the current—

Dr. Meltzer. I will let him answer that.

Dr. Lerrick. Very simply, Mr. Chairman, for the vast majority of IMF loans, leaving aside the special emergency facility which is relatively new, the IMF takes as its base what they call the SDR interest rate, which is an arithmetic average weighted according to size in the world economy, of the 3-month Treasury bill rates in the United States, France and the U.K. and 3-month interbank and CD rates in Germany and Japan.

Representative Saxton. Doesn't it turn out to be about 4.7 percent currently?

Dr. Meltzer. That is correct. And now they are charging somewhat of a penalty.

Representative Saxton. So if my old clients when I used to be in the real estate business went down to the bank today to borrow money for 30 years to buy a house, how much would they pay here in the United States?

Dr. Meltzer. Now, over 7 percent.

Representative Saxton. So 4.7 percent is a good rate of interest, isn't it?

Dr. Meltzer. Yes, it is.

Representative Saxton. There are two subsidies that I can identify here. Mr. Sanford talked about a subsidized rate. Is there a subsidy which the United States taxpayer pays in order to enable these 4.7 percent loans to be paid? And is there a subsidy which we absorb in a different way because the market rate of interest on loans to other countries would be significantly higher than 4.7 percent? So if our Treasury rate is, say, 6 percent, and we are loaning at 4.7 percent, is that not a subsidy? And is it also not a subsidy if the market would charge, say, 15 percent in some risky venture at someplace in the world, and we are loaning at 4.7 percent, are those not two subsidies which are inherent and current IMF practices?

Dr. Meltzer. Yes and yes. We treat the loan as a short-term loan, whereas many of these loans roll over and over again. So we give them the short-term rate, but the loan goes on for many years. Second – and we have some documentation in our Report about how many years, but I won't trouble you with that.

Second, of course, there is the risk premium. That is the second subsidy. We absorb the risk premium.

Dr. Lerrick. Mr. Chairman, also two other sources of costs, subsidies that you are providing. One is the significant portion of the reserve position of the United States on which there is no interest paid at all. On most of it you receive the SDR rate after adjustments, but there is a portion, which is approximately \$2.5 billion, on which no interest is paid at all. In addition, there is a subsidy because the IMF reduces the

rate that it pays on the funds that the U.S. provides by an amount to generate provisions for loan losses.

Unlike a private sector institution or most other financial institutions, the IMF shares the cost of providing provisions for loan losses between the borrowers and the lenders. So they are effectively reducing your rate below the 4.7 percent base. The SDR rate may be 4.7, but the IMF is not going to pay you 4.7 percent. It is going to reduce it to less than 4.7 percent in order to build the provisions for loan losses.

Representative Saxton. Thank you.

Let me talk about the American taxpayers' right – or at least their Representatives' rights to understand how the IMF operates and what happens to American taxpayers' dollars. I remember hearing a 5-minute Saturday address by President Clinton, and he started by saying, “I would like to talk about the IMF. It is not a bowling machine,” an exact quote. He was saying that because the American people not only don't have access to information about the IMF, but unfortunately because of the arcane way or secret way in which the IMF operates, the American people, the taxpayers and their Representatives, I might add, have a terrible time figuring out what the IMF is doing.

This speaks to the issue of transparency. You have made recommendations in your Report about transparency. I believe that Secretary Summers has also made statements about transparency. Would you comment briefly on this subject?

Dr. Meltzer. Yes. You and your Committee deserve a great deal of credit for bringing this issue to the attention of the American public and staying with it long enough to figure out what some of those balance sheets and income statements really look like. Dr. Lerrick has also worked on that for the Bretton Woods Commission and in cooperation with your Committee. I think that it is absolutely inexcusable that we can't pick up the balance sheet and income statement of the IMF and say, this is how much money they have, this is how much money the United States provides for them, this is our share; that they hide behind numbers like 18 percent when you know we are actually paying 26 percent. And all of those things should be transparent, observable, and open to the American public and to the Congress so that people can make reasonable judgments about what is going on.

Mr. Levinson. Mr. Chairman, just to introduce some minimum balance, it is true that there has been a great deal of criticism of the IMF

with respect to transparency, but also let's recognize they are putting much more out with respect to article 4 consultations, summaries. But it is also an international institution, so they have to in many instances get the consents of the governments who are providing confidential information with respect to the economy and finances of the country. But certainly anyone, I think, who knows anything about this would say there is a great deal more information now available.

Secondly, it isn't as if we don't have a representative in these institutions. We have an executive director, a treasury. The Congress can call that representative up and does call her up to testify on the subject matter. The IMF, it seems to me, is not a mystery. It is a credit union. The difference between a normal credit union and the IMF is that instead of taking the members' money and loaning it to the other members, they have what they call an exchange of assets. They purchase the currencies. That creates the element of confusion and difficulty, and it is very difficult to explain, I agree.

Representative Saxton. Thank you. I am going to move on to my next question. We are going to run out of time here shortly.

I would just like to comment that we had the U.S. representative to the IMF before us, and there were several important questions that she could not answer. You may have read her testimony. Beyond that it has taken us three years to get to some answers.

We believe, in our society – whether it is in local government where in New Jersey we have sunshine laws to open the doors, or whether it is in public hearings like this one where we talk about the American taxpayers' money, or whether it is American taxpayers' money being used and decisions being made by an international organization known as the IMF, that the doors ought to be open. That is a pretty simple concept that we have in this country, and one that we are and I am going to continue to work for.

Let me just talk about now the role of the United States Government at the IMF. This is a very interesting topic. When Karin Lissakers was before us, we asked her how decisions were made at the IMF. There had been some large number, 2,000 decisions made at the IMF. We asked her how many votes had been held, and she said 12 to 14. We were curious and went one step forward and asked, how do you make decisions? She said, well, by consensus. I don't know what that means. I guess they get everybody in the room, and they all just kind of nod their heads, and off they go with the decision.

Now, it is interesting to note that the IMF says that the United States has 17 percent, contributed 17 percent of the money to the IMF. But if you define usable money, the United States – that is, money that is actually usable at the IMF, the United States contributes 26 percent. As a full partner contributing 26 percent, it seems to me that the United States ought to have significant say, more than a consensus, about what decisions are made at the IMF.

Would you like to comment on that, Dr. Meltzer?

Dr. Meltzer. I think in many ways it has a very large say about the decisions that are being made, not through the process that you just described, but through a different process through which the Secretary of the Treasury or his aides talk to the Managing Director of the IMF and tell them what it is that the United States wants the IMF to do, and then most of the people in the room nod their head and agree with that. That is why there is not much voting process that goes on.

The U.S. has a lot of influence in the IMF, but it uses it to carry out what I believe is a very poor and unacceptable policy as far as the American people are concerned. That is, they allocate money to programs that the American people don't get a chance to vote on. It uses this as a way of going through the back door and not asking Congress to appropriate money for projects that it wants to have, whether in Russia or Mexico or some other country. That, I think, is the heart of the question and a big part of the differences between those people who like our Report and those who don't.

Representative Saxton. So if the United States Government contributes all of this money and decided that we wanted – either through legislation or through administrative policy – that we wanted to have shorter-term loans issued to the IMF, that we wanted to restructure the subsidization of interest rates, that we wanted the IMF to open their doors, and that we wanted to exert the U.S. influence in a more dramatic way, we could do that, couldn't we?

Dr. Meltzer. We would go a long way toward getting those reforms, yes, sir. That is my opinion.

Dr. Lerrick. Mr. Chairman, I would like to make one comment. It is important to understand that there is not a single decision in any of the international financial institutions that is not made without the agreement and accord of the U.S. Treasury because the U.S. Treasury can stop any other decision from being made. The U.S. Treasury has

veto power over all major decisions. What the U.S. Treasury does, if there is an issue that is important to the U.S. Treasury where it is not in agreement with the rest of the membership, is stop all other programs from going forward in the institution.

So your statement that the U.S. should have significant influence? The U.S. Treasury has more than significant influence in all of the international financial institutions far beyond its percentage ownership, whether it be 26 percent or 17 percent or 13 percent.

Representative Saxton. That is exercised, is it not, through the Department of Treasury, that influence?

Dr. Lerrick. Yes.

Dr. Meltzer. Yes.

Representative Saxton. Now, Secretary Summers has indicated that he thinks it would be a good idea to have shorter-term loans, and less subsidization of rates, and he thought it was a good idea to bring about policy in the IMF that brings about more transparency. So do you expect that those things will happen?

Dr. Meltzer. I light a candle.

Mr. Levinson. I think Dr. Lerrick's statement is really excellent with respect to the fact that the United States has influence. I just want to add one thing. Any director in any one of these institutions has the right to demand an up or down record vote in the board. So if there are decisions by consensus, it is because no director, including our own, has demanded an up or down record vote in which everyone is recorded. But that right exists, and any director can exercise it.

Representative Saxton. The point that I was trying to make is the United States can make – and the point that Dr. Meltzer and Dr. Lerrick were trying to make, and I guess Dr. Calomiris would as well, is that the United States has more than significant influence on decisions that are made, and therefore, if it becomes the policy of this country to make changes at the IMF, it is eminently doable.

Mr. Levinson. They still have to convince the other members. They certainly have influence, but the Europeans and the Japanese also have a significant voice in these institutions. The developing countries are also more assertive. So 26 percent is not 51 percent. There are qualified majorities for recommending new articles or quorums and that kind of

thing, that is true, and the United States can use that to block, as Dr. Lerrick has pointed out.

Representative Saxton. Dr. Calomiris.

Dr. Calomiris. I just wanted to emphasize, too, that the ability to veto or stop something is not necessarily the same as the ability to completely transform the institution. So I agree with Mr. Levinson.

Mr. Chairman, if I can have 10 seconds for the record to make a couple of brief clarifications, I want to point out that contrary to what I think the impression was that Mr. Levinson gave early on, the Majority did not support and does not support the idea of allowing the IMF to impose labor market flexibility on other countries. I just want to emphasize that, that we were not – as I think he suggested – arguing that point.

If you look on page 39 of the Report, we actually say this. I just want to be clear that it is not a one-sided discussion in that respect.

Mr. Levinson. I never implied – the Commission Majority.

Dr. Calomiris. I just want to be clear that we were not in favor of the continuing practice of the IMF telling countries how to run their labor markets.

I also want to agree with him largely on the discussion of the Asian crisis, but I want to disagree a little bit. Here I will use my status as an economist and his as a lawyer to tell him that he doesn't, I think, completely understand the subtleties of the substantial agreement that exists among the people he mentioned, Joe Stiglitz, Jeff Sachs, and myself, for example.

I haven't been able to detect in the analysis of the causes of the Asian crisis much disagreement. All of us agree that there are a combination of factors that led to the Asian crisis. All of us have written about it extensively. The bottom line and the most important point is that the Majority's recommendations take care of all of the elements, that is, strengthening domestic financial systems so that the domestic banks don't have perverse incentives, which Mr. Stiglitz has emphasized, Mr. Sachs has emphasized and I would emphasize. That is part of our proposal; providing greater liquidity through the IMF to prevent unnecessary melt-downs, all three people would be in favor of.

So our proposals do not stand or fall depending on what weights you attach to the different explanations of the Asian crisis. I just want to make that clear.

Representative Saxton. Thank you.

So far my questions have all centered around points of agreement between the administration, your Commission, and even the Majority of this Committee. Let me ask a question that I am not sure there has been agreement on.

I went to Russia in November, and one of the primary reasons I went was to try to get the members' of the Russian Duma perspective on what happened to IMF funds that were loaned to Russia. It became very clear to me before, during and after that trip that the IMF does not have effective procedures or safeguards in place to verify information and monitor funds after they are disbursed. And I repeatedly talked about this back in 1998 and 1999 and, of course, again this year because of the Russian experience that we had.

It seems to me to be quite incredible that an institution entrusted with public funds for over half a century would not have effective accounting controls and safeguards in place to monitor funds that flow through it to other countries. Would you comment on your perspective on that?

Dr. Meltzer. Yes. It is a deplorable fact that when the money goes to the Central Bank of Russia, that the IMF has no knowledge or ability to constrain where that money goes. That is one of the reasons why, in thinking through our World Bank proposals, we tried to come up with a scheme which the money would not go through the central banks, but would be paid to the vendors. I think no one who knows about that system can say that it is anything but a deplorable system, that we have no real mechanisms in place to control corruption.

Mr. Levinson. I think that there is a basic conceptual issue here, Mr. Chairman. The IMF makes the money available to the central bank. It has a negative list, usually, for which the central bank certifies the money will not be used. The central bank can use the money to put it into its reserves. It can pay for imports. It can make the money available for capital investment or borrowing by domestic banks. There is not an indelible ink that is put on IMF dollars that you can then trace through. That is impossible to do. You are dependent upon the—

Representative Saxton. Are you defending the status quo?

Mr. Levinson. No. What I am saying is you have a situation where unless you are going to specify that the money can only be used for imports of a certain nature or some such thing like that, there is no way that you can provide liquidity or balance of payments financing for

a country and then follow the money through to its ultimate uses. That defeats the whole purpose of making the money available to meet immediate needs of the country in crisis.

Dr. Meltzer. If we limit the IMF to short-term loans and do the development aid through the system of grants that we propose, then a great part of that problem goes away, Mr. Chairman.

Mr. Levinson. Even the short-term money can't be followed. The money that goes into the central bank can go into the reserves. It never leaves.

Dr. Meltzer. If we give a country that is *in extremis* – and that really is the Commission's proposal; that is, it can only borrow from the IMF when no one else is willing to lend, when the markets are closed – then under those circumstances we can be pretty sure that the money is going to be used – short-term money is going to be used for the designated purpose.

It is true what Mr. Levinson says. We can't tag the dollars to know that they went there, but if they have a balance of payments crisis, they are unable to pay their debt, under those circumstances we give them liquidity aid because no other bank in the world is willing to lend to them, then we can be pretty sure that they are going to use that – that that makes a marginal difference to them in their ability to pay their debt. That really is the purpose of making them a lender of last resort.

Mr. Levinson. You still are not going to be following the individual dollars as to whether it was used for debt repayment or for imports or stayed in the reserves.

Representative Saxton. What Dr. Meltzer is saying is that there will be less propensity to misuse funds if loans are made over a short term, unlike last summer when the IMF disclosed that it had been lied to by the Russian Central Bank in previous loans and at the same time announced approval of a new series of loans for Russia, which I then went to follow, and it was kind of interesting. Members of the Duma decided it was all American bankers' greed that provided for the outflow or missing funds. So it was very interesting.

Well, we are essentially out of time. Dr. Meltzer, I wanted to ask you one final question about legislation that I have introduced relative to IMF reform. I won't go into all of the aspects of it, but it is very similar to the subjects that we have been discussing here, the role of the United States, the length of terms, subsidization of rates, and the need for

transparency. Do you generally agree – have you looked at the bill, and do you think it is generally moving in the right direction?

[The bill H.R. 3750, the *IMF Reform Act of 2000*, appears in the Submissions for the Record on page 51.]

Dr. Meltzer. I have read the bill and the press release on the bill, and I think it generally moves in the right direction, sir. I think the idea that you have come up with of using our ability to withdraw our funds, that is, to withdraw our tranches from the Fund, as a way of disciplining the Fund and encouraging them to do things is a step that we would want to take hesitantly, but we should not be unwilling to take.

Representative Saxton. Thank you very much. I want to thank all four panelists for being with us today. Mr. Levinson, Dr. Calomiris, Dr. Lerrick, Chairman Meltzer. You folks have toiled together with some difference of opinion for a long and arduous task that you undertook. We appreciate all of your points of view, and we appreciate very much that you have come out with a work product that we think – that I think personally moves this process forward very smartly. Thank you very much.

Dr. Meltzer. Thank you, Mr. Chairman.

Representative Saxton. The hearing is adjourned.

[Whereupon, at 11:40 a.m., the hearing was adjourned.]

SUBMISSIONS FOR THE RECORD

PREPARED STATEMENT OF REPRESENTATIVE JIM SAXTON, VICE CHAIRMAN

It is a pleasure to welcome Dr. Meltzer and our other witnesses before the Committee this morning. Dr. Meltzer served as Chairman of the International Financial Institution Advisory Commission, and the other members of the panel were also associated with this Commission. I would like to compliment you for taking the time and effort to grapple with some of the most complex and challenging issues in economic policy, and producing such an excellent report. Today we plan to focus on the substantive economic and financial issues related to the International Monetary Fund (IMF) and World Bank, and how they relate to proposals for reform.

As one who has been involved in issues related to reform of the IMF for several years, I am encouraged by the emerging consensus that has developed on basic principles. The principles stating that the IMF should provide more transparency, focus on short-term crisis lending, scale-back IMF development lending, and end deep IMF interest subsidies, now enjoy broad support. There is significant agreement on a range of other issues as well.

The main question remaining is how to consistently apply these concepts of IMF reform. Tactical differences in the application of these principles should not be permitted to distract attention from how much consensus has been achieved on basic principles of IMF reform.

For example, recently Secretary Summers has called on the IMF to focus on crisis lending, de-emphasize development lending, and raise at least some IMF interest rates. This is very encouraging to those of us in Congress who have supported these objectives for quite some time, and thus welcomed Summers' embrace of IMF reform. As news reports noted at the time, Summers seemed to borrow heavily from Congressional critics of the IMF and from the expected recommendations of the Meltzer Commission.

Our perspective here at the JEC has focused on transparency and the finances of the IMF. These two issues are closely related, and have important implications for Congress. As a former IMF research director recently said, "the Fund's jerry-built structure of financial provisions has

meant that almost nobody outside, and indeed, few inside, the Fund understand how the organization works..."

However, the IMF is a publicly financed institution in which the U.S. has a prominent financial and policy making role. Congress has an important responsibility to monitor how effectively taxpayer funds are being used and ensure that adequate safeguards are in place. Obviously, this lack of IMF transparency undermines Congress' ability to carry out this oversight responsibility. We have finally managed to decipher and decode the IMF's accounts, but IMF finances really are not understandable and do not comply with the transparency standards the IMF imposes on others.

Our Committee findings show that the base of IMF financial support is much narrower than officially portrayed, with the U.S. contributing 26 percent of usable resources, and the G-10 contributing 77 percent. Over half the IMF membership contributes virtually no usable funds. Furthermore, in one recent period, 70 percent of IMF credit was owed by just five borrowers. Russia and Indonesia together accounted for one-third of outstanding credit. IMF interest rates are currently about 4.7 percent, far below the market rates available to IMF borrowers, and below the rates available to the most creditworthy nations such as the U.S.

Two years ago the JEC also found that there were no effective safeguards or accounting controls in place to monitor IMF loan disbursements. Billions of dollars would be disbursed by the IMF with no effective accounting controls in place to enable the IMF to verify information and ensure that funds were properly used. Given the rather low public integrity standards in place among many IMF borrowers, this cavalier approach fails to take into account the fiduciary responsibility of the Fund to member countries and their taxpayers. After repeated public embarrassments, and my introduction of legislation mandating IMF accounting controls, it is good to see the IMF finally taking long overdue steps to address some of these issues.

Although most of our research at the Committee has focused on the IMF, reform of the World Bank is also needed. The overlap of IMF and World Bank development activities is acknowledged by each agency, but is apparently not viewed as a problem. Not only is the IMF involved in many development activities, but the World Bank has participated in bailouts during economic crises.

A clear distinction between the different missions of the IMF and World Bank is urgently needed, and this problem also is addressed in the Meltzer Commission Report. The World Bank should focus its efforts on helping the poorest in nations that have no alternative sources of funds, and should do so mostly through grants, not loans, as the Commission recommends. We should reduce the burden of debt on the poorest nations, not perpetuate this problem with more lending from the IMF and World Bank.

The Congressional agenda for reform of the IMF and the World Bank is as ambitious as it is compelling. However, in the case of the IMF, the Congress has provided over one-quarter of the usable resources, more than the three next largest contributors combined. Over time, a continual assertion of Congressional pressure can make a tremendous difference, and this is the intent of the *IMF Reform Act of 2000*, which I have recently introduced. Congress is in debt to Chairman Meltzer and the Commission for providing an excellent blueprint for reform of the IMF and World Bank.