# The one and only problem with the IMF

*William Engdahl recounts the history of the International Monetary Fund, and tells why it must be replaced.*

One of the least-understood aspects of the ongoing financial and monetary crisis spreading out from Asia, has been the role of the International Monetary Fund in that crisis. Its defenders claim that without the swift response of the IMF to the crises in Thailand, then in Indonesia, and then in South Korea, the Asia crisis would by now have become a global systemic crisis whose consequences would be incalculable.

But careful examination of the IMF's role today, not only in Asia, and an examination of the historical evolution of this most important supranational agency, leads to the far different conclusion that there is one, and only one thing wrong with the IMF: It's no damn good. It must be dissolved, and must be replaced with an entirely new organization appropriate to the principles of fostering national sovereignty and increasing per-capita economic prosperity on the planet.

Since the outbreak of the Thai currency crisis in May 1997, the IMF has been at the forefront of organizing over $120 billions in emergency rescue funds to try to contain panic, and prevent it from detonating a global systemic crisis. The results, as of this writing, are worse than a failure, they are catastrophic. The IMF "conditionalities" medicine, in fact, rather than curing the patient, has nearly killed him in each case, and now threatens to take the rest of the world's fragile financial system down with it.

On Jan. 13, details from a confidential IMF memorandum, prepared for Fund Managing Director Michel Camdessus and senior IMF management, were leaked to the public. The memo outlined in minute detail, how, in the case of Indonesia, IMF policies had turned a difficult situation into an impossible one, one which today threatens to detonate yet a new round of instability in Asia and beyond.

## The Indonesia debacle

Last November, when most people still foolishly believed that the Asia crisis was not of a dimension to pose a global threat, IMF Washington headquarters ordered the closing of 16 insolvent banks in Indonesia, including one bank owned by the son of President Suharto. The argument in IMF headquarters, was that the move was needed to "restore confidence" in the Indonesian financial system. As the confidential IMF memo detailed, the move inspired panic instead, as tens of thousands of Indonesians lined up to pull their money out of all Indonesian banks, in fear of losing everything.

The IMF memo admitted, after the fact, "These closures, however, far from improving public confidence in the banking system, have instead set off a renewed 'flight to safety.' " The memo noted that Indonesian citizens abruptly withdrew a crippling $2 billion out of the banking system within days of the bank closings.

By the end of November, the result was a crisis in which two-thirds of all Indonesian banks "had experienced runs on their deposits," according to the IMF. The situation became so critical, that the Indonesian Central Bank was forced to pump money into the banking system to avert a complete collapse—a huge sum, "equivalent to about 5% of GDP in the past two months," the IMF memo stated. That flood of money, in turn, weakened Indonesia's currency, the rupiah, to a point where currency panic set in by late December, a situation which Indonesia at present has little prospect of resolving alone.[1]

Pouring even more gasoline onto the Asian fires, the IMF has ordered Indonesia, Thailand, as well as the far larger South Korean economy, all to follow the orthodox IMF recipe for getting emergency IMF money: Cut budget deficits, cut inflation, close weak banks, eliminate state controls on the economy, and remove state price subsidies on food and fuel and other necessities.

In Indonesia's case, the IMF has demanded seven basic conditionalities to get a $39 billion bailout package: Keep inflation below 20%, but avoid an economic recession; hold down the state budget to not more than a 1% of GDP deficit (Germany's is 3% of GDP); move special off-budget government expenses onto the official budget; cancel many "wasteful" public projects; make the central bank independent in monetary policy, so that it can raise interest rates as high as necessary to defend the rupiah; restructure banks and companies; and break up trade associations, such as in timber.

These seven IMF demands are utterly irrelevant to Indonesia's actual currency crisis. In fact, once imposed, the IMF conditionalities will *aggravate* the currency crisis, by putting

1. David E. Sanger, "IMF Now Admits Tactics in Indonesia Deepened the Crisis," *New York Times*, Jan. 14, 1998.



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*U.S. Treasury Secretary Henry Morgenthau opens a session at the Bretton Woods International Monetary Conference, 1944. The IMF's original mandate was limited to stabilizing the currencies of war-ravaged Europe; its role as a debt policeman and enforcer of fascist austerity emerged later, after the financial shocks of the 1970s.*

the economy into severe recession and weakening export cartels which had previously organized hard-currency dollar exports. All this, even after the IMF created the earlier bank panic.

The currency collapse which has resulted, has in turn created the full-blown foreign debt crisis, as domestic banks and companies found, in a space of weeks, that the rupiah had fallen by 84% against its dollar level of last August.

Unlike in Mexico or other countries of Ibero-America, which were forced to turn to the IMF during the 1980s debt crisis, the East Asian economies as a group did not suffer from any of the same inherent problems when the crisis suddenly hit last year. They had no chronic budget deficits, no chronic inflation, let alone hyperinflation, no unstable macroeconomic policies, and most of their debt was not state debt (as in Argentina and Brazil), but rather private loans.

How can the IMF be capable of such manifest incompetence? It is not by accident or oversight. Indeed, they have worked hard over years to perfect their incompetence.

## Beginnings in Bretton Woods

The International Monetary Fund, arguably the single most powerful financial institution in the world today, is also the least understood. It is a product of the July 1944 Bretton Woods, New Hampshire international monetary conference. That conference, convened by President Franklin Roosevelt to prepare the basis of postwar economic reconstruction, saw 44 nations gather with the United States to sign what were called the Articles of Agreement of the International Monetary Fund. On Dec. 27, 1945 the IMF began operation. Each member would contribute to a central fund, based in Washington to assure that it would win the confidence of its member-states in the postwar period. The Fund then should lend, in special circumstances, according to agreed-upon conditions, to its members-nations in need.

The infamous IMF "conditionalities" policy for procuring emergency loans, was finally cast into a rigid formula at the end of the 1950s, and remains in force to this day. Over the past four decades, the entire IMF bureaucracy has been cultivated and recruited internationally from those who ideologically support this monetarist orthodoxy of IMF conditionalities.

The prospective recipient of IMF money must convince IMF inspectors that it is implementing policies of "establishing or maintaining the enduring stability of the currencies concerned, at realistic rates of exchange." "Realistic," of course, is defined by the IMF. The focus on the vital exchange rate allows the IMF to control a country's fiscal policy, government expenditure, tax policy, and public enterprise policy—in short, every aspect of national economic life. Yet, as the Asia crisis has proven, the IMF is irrelevant to the actions of highly leveraged offshore hedge fund speculators, such as George Soros, who cause devastating currency chaos without warning.[2]

The Fund lends under a "standby arrangement," rather

2. Per Jacobsson, *International Monetary Problems, 1957-1963* (Washington, D.C.: IMF, 1964), p. 20.

than a lump-sum loan. This gives the IMF ongoing political control over the recipient government, to force the country to swallow its harsh medicine, or else face losing the remaining tranches of the loan. As the IMF refers to it, this technique strengthens the hands of the IMF to induce the country "to implement more energetically policies designed to maintain the monetary stability and liberal payments system required." That is, strict control of credit and full convertibility of the currency—precisely what the IMF is demanding with such devastating consequences in Asia today.

The United States, as the IMF's largest member economy and as the largest holder of gold reserves after the war, contributed the largest quota into the Fund, and as a result, it initially held 31.5% of the voting rights. Today, while still holding the largest share, the U.S. vote has been diluted to 17.8%.

The United Kingdom and five founding members from its British Commonwealth and the British Empire, including India, South Africa, Australia, New Zealand, and Canada, together held the second-largest bloc at Bretton Woods, some 27% of the initial total IMF voting shares, a very heavy weight which had been urged upon the United States by British Prime Minister Winston Churchill and economist John Maynard Keynes, represent His Majesty's Treasury. Churchill and Keynes had argued that Britain's vast colonial Empire justified such an influence, despite the bankrupt state of Great Britain itself in 1944-45. By contrast, France, which also could boast a large colonial empire at that time, received a mere 5% of total voting rights in the new IMF. Churchill's Atlantic "special relationship" was still powerful in 1944.[3]

## The witch-hunt against Harry Dexter White

The original IMF articles were the result of months of intense arguing and debate between the two major convenors of the Bretton Woods conference, the United States, represented by Treasury Undersecretary Harry Dexter White, and Britain, represented by Keynes. In the end, Britain had to cede major points to the U.S. plan devised by White, whose initial proposal to Treasury Secretary Henry Morgenthau and President Roosevelt called for creation of a Stabilization Fund to prevent a repeat of major currency crises, as had occurred during the 1930s. White's Stabilization Fund was to work together with a Bank for Reconstruction and Development, to provide long-term reconstruction dollar loans to the postwar world, especially Western Europe. These two plans eventually became the basis of the IMF and World Bank.

Keynes's British plan, on the other hand, had advocated the creation of a Clearing Union, and a new supranational currency, which he termed the "unitas."

In the early 1950s, during Joe McCarthy's "red scare" in the United States, Harry Dexter White was charged with having been a "communist sympathizer," and even a communist spy, a charge which undermined White's role in negotiating the U.S. terms of Bretton Woods, and his later as head of the American Mission to the IMF. All subsequent evidence indicates that White had negotiated as part of an overall American position at the time, for the creation of an IMF which would be appropriate to the task then at hand, in keeping with President Roosevelt's vision of a non-imperial postwar world.

Given what has subsequently emerged about the role of London's U.S. embassy in fomenting McCarthy's red scare, it is likely that London channels had deliberately fed the name of Harry Dexter White to McCarthy and J. Edgar Hoover's FBI in Washington, in order to weaken the U.S. role in the new IMF organization. White, like many around FDR, was certainly no Anglophile. In November 1945, White had drafted a memorandum to Morgenthau, in which he wrote, "It matters little what our political relationships with England becomes or what happens in the Balkans or the Far East, if the problems between the United States and Russia can be solved."

The Soviet Union had been among the initial participants at Bretton Woods, but later, Stalin declined to join the IMF.

The attacks on White as a communist spy had served to weaken American influence on the determination of IMF policies. It soon became unwritten law, that the managing director of the IMF must always be a European, preferably a French monetarist, such as currently, with Michel Camdessus, and, before him, Jacques de Larosière, and before him, Pierre-Paul Schweitzer—all from the Bank of France. Those three French central bankers have controlled IMF policy since 1963, with the exception of a five-year stint by a Dutch monetarist Sufi, Johannes Witteveen, from 1973-78.

## The IMF's original mandate

At first, the mandate of the IMF had been clear to all major powers in 1945. It was to concentrate on stabilizing the major industrial economies of the postwar world, and little else. U.S. Treasury working papers spoke of U.S. aims at Bretton Woods, to create a multinational fund that would "prevent the disruption of foreign exchanges and the collapse of monetary and credit systems; to assure the restoration of foreign trade, and supply the huge volume of capital required for reconstruction, for relief and for economic recovery."

There was no debate at Bretton Woods on how the IMF would assist the developing economies of the world. It was never considered part of the role of the IMF. The assumption

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3. See "Articles of Agreement of the International Monetary Fund," Washington, D.C.: IMF, 1988. Britain's "special relationship" was primarily a coziness with Anglophile circles in the U.S. financial centers; that coziness was not, however, shared by President Franklin Roosevelt, who viewed the British Empire as the mortal enemy of the United States, and had vowed to eliminate it, and all other empires, from the planet, following the war. See Elliot Roosevelt's account of his father's harsh conflicts with Churchill, in Elliot Roosevelt, *As He Saw It* (Westport, Conn.: Greenwood Press, 1974). Roosevelt's intent was foiled by his death on April 12, 1945, and by his successor Harry S Truman, who became a willing dupe of the very powers Roosevelt had vowed to destroy.

was that the recovery of the European economies would pull the developing economies up along with them.

In short, the IMF was conceived in order to stabilize the currencies of the war-ravaged economies of Europe, which at that time was the major task confronting the United States.

This fact is central to the case today for dissolving the IMF.

The mandate of the IMF, when it was founded, was to deal with "temporary" balance-of-payments problems of member countries. This was to be done by drawing on the pool or fund of contributions of member countries to come to the aid of a requesting member. The loans were to be for short-term problems, and fully repaid within five years.

In 1945, the United States' concern was to rapidly restore levels of international trade among leading nations of Europe and with the United States. Most directly, Britain had the difficult task of dealing with a deficit in its balance of payments caused by the collapse of industrial exports and destruction of production during the war. To restore "equilibrium" in its balance of payments, it could either exhaust its precious foreign currency reserves, or liquidate British investments abroad for cash.

To Britain, the idea of a pool of the reserves of many nations, above all of America, was a way out of its postwar dilemma. The borrowing would allow Britain to finance urgently needed industrial imports to restart production and repair war damage. Hence the central notion of IMF loans to "restore equilibrium" in a country's balance of payments. The war had destroyed the essential equilibrium, as it was seen. For France and other countries of war-torn Europe, similar considerations were primary.

A member in a short-term balance-of-payments crisis could apply to the Fund for a stabilization loan of up to five years. This would give time to restore damaged industrial export capacity and to restart the economy. The IMF was intended for the advanced, mature industrial economies of Britain and continental Europe, which possessed more than a century of experience with modern industry, skilled labor, and advanced financial systems. It was assumed that they, in turn, would regulate trade with their colonies.

## A fundamental shift in policy

The Fund continued to function as lender of last resort to member countries of the Organization for Economic Cooperation and Development, up until 1977, when the last such IMF loan was taken by Italy. Since that time, the IMF has never again made any loan to any major industrial OECD member. At that point, following the British-orchestrated oil shocks of the 1970s, the rational decision would have been for the United States and other members to administer to the IMF a "death with dignity," and to dissolve the institution as an one no longer relevant to the world's economic needs.

But certain influential persons had other tasks in mind for the IMF.

Following the two oil shocks of the 1970s, countries of the developing sector, as well as Poland and certain other countries of the Warsaw Pact, all had begun to borrow huge sums from the London-based Eurodollar banks. The loans were taken in order to finance the sudden and growing balance of payments problems created by the arbitrary 400% hike in their cost of oil imports.

The London Eurodollar banks, aware of the severe conditionalities posed for these countries were they to seek emergency balancing loans from the IMF, offered the borrowing country generous private loans from the offshore Eurodollar market. That market, centered in London, had arisen from what President Nixon's Secretary of State, Henry A. Kissinger, called "recycling of petrodollars," the huge dollar windfall accruing to the Organization of Petroleum Exporting Countries from the oil shock. The cynical banks reloaned the deposits from the oil exporters to the victims of the 400% price hike which Kissinger had personally helped to engineer, along with the same bankers. Citibank Chairman Walter Wriston justified the huge lending to Ibero-American governments with the quip, "Companies can go bankrupt, but states, never."

The small print on the petrodollar loans all contained an explosive clause: Interest on the loans would "float" according to rates on the London Interbank Offered Rate (LIBOR) market. Before British Prime Minister Margaret Thatcher's June 1979 interest rate shock, followed four months later by Federal Reserve Chairman Paul Volcker's rate hike in the United States, the London loan rates were seen as a "bargain." By the end of 1979, the LIBOR rates on Third World Eurodollar loans had jumped almost 300% in a matter of weeks. The fuse of the "Third World debt bomb" had been lit.[4]

## IMF becomes a debt policeman

When that debt bomb exploded in August 1982, as Lyndon LaRouche had predicted (see article in this issue, p. 29), with the announcement by Mexico to Washington that it was unable to pay its next dollar loan installment to New York banks, the IMF was transformed from a moribund relic of postwar reconstruction, to the agency enforcing savage austerity and forced cuts in living standards.

Following the Mexico default in 1982 and the ensuing world banking crisis, London and New York banks led a concerted effort to loot the debtor countries, to enforce repayment of (in fact) illegitimate levels of debt service, beyond anything they had ever dreamed possible. On the insistence of the administration of President Ronald Reagan, Paul Volcker's Federal Reserve Bank, and the New York creditor

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4. For details on the role of Kissinger and the secretive Bilderberg Group at their May 1973 Saltsjoebaden, Sweden meeting in planning the 1973-74 "oil shock," see William F. Engdahl, *A Century of War: Anglo-American Oil Politics and the New World Order* (Wiesbaden, Germany: Böttiger Verlag, 1993).

banks, the IMF developed a new program of strict "conditionalities" to be imposed by the Fund on Third World debtor countries.

These conditionalities were developed by an IMF official, Irving Friedman, who later became a top executive with Citicorp. Friedman stated in an interview in late 1988, "My thought was, we would hold out the use of the Fund resources as a kind of carrot to countries. You first have a very serious review of the country's economic situation. You identify the source of the difficulties, you point out what things have to be changed."

The IMF formula was invariably the same: The debtor country was forced to slash imports, severely devalue its domestic currency (ensuring that the relative dollar-denominated debt increased by multiples), and impose draconian cuts in government subsidies for food and other necessities, while opening vital areas of its national economy to foreign takeovers on the cheap, justified as "free market reforms" by the IMF.

Since 1982, the IMF "structural adjustment programs," as they termed them, have been a precondition for the commercial banks to enter into "loan-restructuring agreements" between the private banks and the debtor country.

The IMF, for example, forced Mexico to slash government spending, eliminate state food and other subsidies, and devalue the peso from a rate of 12 to the dollar in 1982, to an incredible 3,300 to the dollar, before the "new" peso was introduced in early 1993. Imports of medicines, industrial goods, and the like just stopped cold. People died without need. The creditor banks continued to collect the debt.

The London-based Eurodollar creditor banks, organized in a "creditors' cartel" of banks (dubbed the Ditchley Group for their first meeting at Ditchley Park outside London), spoke piously of the "responsibility" to honor debts, while threatening that a defaulting debtor would never see a penny of foreign credit. It was a hollow threat, which was remarkably effective.

According to World Bank figures, in 1980, total external debt, private and public, of more than one-year maturity, for 109 developing countries, stood at $430 billion. Since 1980, these 109 countries have paid an impressive amount to their creditors. Repayment of interest alone between 1980 and 1986, totalled $326 billion. Repayment of principal on the same debt totalled another $332 billion. Thus, in sum, these 109 developing countries repaid $658 billion between 1980 and 1986 on their original debt of $430 billion. Yet, the total external debt outstanding, according to official World Bank/IMF figures, was $882 billion by 1986! The scheme was simple "IMF bankers' arithmetic": The more you pay, the more you owe, owing to floating interest debt, and the economic impact of IMF conditionalities.

Bank reschedulings since 1982 have added hundreds of billions to the total outstanding debt of what are now known as "Third World," or, more callously, less developed country (LDC) debtors. With IMF controls on the domestic economy, the banks lent only enough to guarantee that the debtor can service interest on the debt. Under U.S. law, so long as interest payment is current, banks can claim the totality of the debt as assets on their books for purpose of other lending, even if they never get a penny of the principal.

No new direct bank loans to Third World debtor countries occurred after 1982, until a new phase began in the early 1990s. Yet, the total amount of external debt owed in dollars for the 109 countries ballooned to more than $1.6 trillion by 1994, an increase of some $1.2 trillion since 1980.

## Crowbar for globalization

A marked shift in the IMF's and World Bank's role emerged in October 1985, when U.S. Treasury Secretary James Baker III called a meeting in Washington of the heads of Chase Manhattan, Citicorp, and the nation's other large international banks, together with Federal Reserve Chairman Volcker. They worked out a strategy of using the funds and the powerful institutional pressure of the IMF and World Bank, in coordinated manner, not just to ensure collection of the old debts, but to impose new demands for market liberalization, privatization of state industry, and other measures, on Third World debtor countries—what today is termed "globalization."

The World Bank was transformed, in the late 1980s, into an arm of the industrial globalization process. Many Third World governments and their civil servants at the World Bank, feebly protested at the time, that the bank was being turned into a crass tool of multinational expansion into cheap-labor developing markets.

In his Sept. 27, 1993 address to the annual IMF and World Bank meeting, Michel Camdessus warmly praised the process of globalization then fully under way: "The most significant development of the closing decades of this century, is the phenomenon of globalization, which is transforming our economic life."

World Bank loans were redirected away from earlier assistance to developing lands to build needed infrastructure, such as hydroelectric dams or power plants, instead to be used as incentive grants—"carrots"—to push globalization and force the opening of developing economies to large multinationals.

Liberal new currency convertibility rules imposed by the IMF and World Bank meant that foreign multinationals were able to withdraw profits out of the country with no restriction—a critical feature, allowing George Soros's Quantum Fund and other offshore hedge funds to trigger the Asia currency crisis in May 1997.

The IMF and World Bank became the institutional "crowbar" for the new globalization. No IMF "approval" was given a debtor country in the past decade, unless they had first agreed to impose the agenda drawn up by multinational U.S. and European banks and industry, namely, massive local currency

devaluation against the dollar, and opening of domestic market protection and wholesale privatization of state industries, allegedly to reduce the state budget.

The new IMF policy has created what James Morgan of BBC approvingly termed a "neo-colonialism": colonialism of stateless global banks and multinational companies, under the protection of the IMF and World Bank, much more efficient than the colonialism of national powers such as Britain or France in the last century.

As a consequence of a full decade of credit cutoff and economic pressure from the IMF, developing countries were forced into the desperate position of actually demanding participation in this globalization of their economies, and loss of national economic sovereignty.

Beginning the early 1990s, the IMF policy was extended to the economies of the former Soviet Union, as well as to Poland and other parts of Eastern Europe, with devastating consequences. The aim was geopolitical and economic: to ensure a weak, balkanized, foundering Russia, and to pry open the centralized economies of the Warsaw Pact to looting and globalization, using the IMF as it had worked in Ibero-America. One minor problem—namely, the fact that many Warsaw Pact countries were not IMF members—was rapidly solved.

At the June 1990 Group of Seven Economic Summit in Houston, President George Bush, at the urging of Britain's Margaret Thatcher and France's François Mitterrand, agreed to place the IMF in control of the entire economic restructuring process in the Soviet Union, as it had done in 1989 with Poland and Yugoslavia. In the case of the IMF demands on Yugoslavia, that had been a major factor in creating the grave economic rifts which fed the genocidal Balkans wars some months later.

The G-7 was so eager to put the IMF in control of the process, that they waived the requirement that the Soviet Union first join the IMF. It was granted special "associate member" status, so as to allow the IMF to dictate policy. The incompetent Jeffrey Sachs was brought in to implement IMF privatization, via his infamous "shock therapy," as an integral part of the process.

## 'In the name of God, go!'

At this juncture, there is every argument for the U.S. Congress not merely to deny the requested IMF quota increase which is currently under debate, but to abolish the institution entirely. While there clearly are factions inside the IMF opposed to the policies of monetarist destruction, the managing director is firmly in control.

It has not escaped the notice of some in Asia, that the consequences of the Asia crisis will likely be as one London banker termed it, "to eliminate the Asian industrial competitive threat for European industry for at least a generation." It is well-known that French industry is especially alarmed at its competitive disadvantage, and some charge that French state banks played a leading role in at least the initial speculative attacks against East Asian and Hong Kong currencies. "The Paris bankers I speak with aren't worried about Asia losses," one French banker told *EIR*. "They simply say, 'The IMF will bail us out if necessary.' " They appear to have confidence that Michel Camdessus is working in their interest.

Regardless of whether such is the case, the reality is that from top to bottom, the IMF today bears no resemblance to the agency envisioned by FDR and others in 1944 at Bretton Woods. The IMF is rigidly monetarist in policy. Even the senior Americans in the IMF are "Chicago School" Milton Friedman monetarists, such as former Milton Friedman student, IMF Director of Economic Studies Michael Mussa, and Deputy IMF Managing Director Stanley Fischer, a former University of Chicago economics professor. The man in charge of IMF policy in Russia and eastern Europe since 1990, John Odling-Smee, is a monetarist who came from Thatcher's U.K. Treasury.

The time is long past due for convening a New Bretton Woods conference. For the present IMF, to paraphrase the charge of Oliver Cromwell to Britain's Long Parliament three centuries ago, "You have been sitting here too long for any good you have done. In the name of God, go!"


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