# Global Warning

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When the International Monetary Fund held its annual meeting in Washington last October, many participants were gloomy, saying that the global economic situation was the worst it had been in 40 years. Yet at no time did the doomsayers explain how they came to that view. Indeed, that same week, the IMF issued a report saying that world economic growth in 1998 was expected to be 2 percent (adjusted for inflation). With the world's population growing by about 1.3 percent each year, world economic growth per capita -- if the IMF is right -- will be about 0.7 percent this year. In other words, average per capita incomes are growing. Combine that with the fact that per capita incomes worldwide have grown at modest to high rates for the past 40 years, and the conclusion is inescapable: the global economic situation, measured by per capita gross domestic product, has never been better.

CRONY EXPRESS

Of course, this doesn't mean that economic conditions around the world are hunky-dory. "Crony capitalism," for example, has badly damaged South Korea, Indonesia, and Malaysia. The South Korean government has forced lenders to waste their money on its favored firms. Indonesia is mired in monopolies on imports and domestic production. Malaysia's prime minister diverted a large part of Malaysians' savings toward his political allies. As for Japan -- the postwar economic powerhouse of Asia -- it is hobbled by excessive taxation. Between 1989 and 1992, notes the Hudson Institute economist Alan Reynolds, the country introduced a new value-added tax (VAT) and taxes on dividends, capital gains, and property. More recently, Japan's government undertook a ¥70 trillion (about $568 billion) program of spending on government projects. These Hooveresque policies -- increasing taxes and spending -- have helped keep the Japanese economy stagnant for about eight years.

Russia's economy is being strangled by massive regulation, and its taxes are also severe -- a high VAT, high corporate taxes, and triple taxation of private pensions, to name three. Russian coal companies, trying to avoid the government's high taxes on cash sales of coal, bartered it instead. This left the companies with no

money to pay workers; the recent coal miners' strike was therefore an indirect tax revolt. Brazil's and Mexico's economies, after decades of regulation, high government spending, and high inflation, are weak. And, of course, Africa is still home to many of the world's sickest economies.

But let's be clear: the United States is less vulnerable to other countries' poor economic performance than any other country in the world. In 1997 U.S. exports were only about 12 percent of GDP, and imports were only about 13 percent. If a worldwide economic slump reduced our trade sector by a third -- a dramatic reduction -- our economy would probably shrink by only about 1 percent. Compare this with the Great Depression, in which real U.S. GDP fell by 30 percent between 1929 and 1933. For all the worry about South Korea, for example, that country's whole economy is about the size of Los Angeles County's. We should care about people in other countries, not because their economic conditions have a huge impact on ours, but because those who are hurting, wherever they happen to live, are fellow humans. And the caring solution to the world's economic problems is, as it always has been, more economic freedom, not less. The most effective strategy that the U.S. government can follow is a variation on the Hippocratic oath: undo harm, and do no further harm.

FUND AND GAMES

How we can do undo harm? Abolish the International Monetary Fund, or, failing that, withdraw U.S. government participation from it. The IMF's original mission, determined in 1944, was to support fixed exchange rates; in 1971, however, exchange rates were floated, and the IMF began looking for a mission to ensure its survival. Unfortunately, it found one. The IMF now lends, at below-market rates, tens of billions of dollars to governments that have ruined their countries' economies. In 1994 and 1995, for example, a consortium that included the IMF, the U.S. and other governments, and various international agencies subsidized a $50 billion loan to Mexico. The IMF cites Mexico as a success story. By the IMF's standards, it may well be: certainly the banks and other lenders that had made loans to Mexico were bailed out. But per capita GDP in Mexico has not yet returned to its level before the crisis. To assert that the bailout was a success in a broader sense, the IMF's supporters would have to establish that the average

Mexican would be much worse off had the IMF and other organizations not acted. They have not done that.

Moreover, even if the Mexican bailout had succeeded in this broader sense, the IMF subsidy sent, and continues to send, two dangerous messages: first, if you're a government official who screws up your economy enough, the IMF will bail you out. And second, investors can make much riskier investments than they would without the IMF because the downside is covered. For investors, it's "Heads I win, tails I break even."

THRIFT SHOCK

In a recent Fortune article, Paul Krugman, an MIT economist, asserted that the IMF couldn't be all that harmful because it has "very little actual money." But apply that same reasoning to the savings and loan crisis of the '80s. In a move similar to the IMF's subsidization of investors' risk, the Federal Savings and Loan Insurance Corporation's (FSLIC) deposit insurance bailed out depositors in money-losing S&Ls, giving depositors zero incentive to monitor the S&Ls' loan portfolios. In 1983, shortly before the S&L crisis was at its worst -- it cost more than $150 billion in present-value terms -- the FSLIC had only about $6.4 billion in its kitty. Think of the IMF as a giant FSLIC. The crucial factor is not, as Mr. Krugman would have it, the IMF's funds at any point in time; it is how much more the IMF can get -- and just recently the U.S. government gave it $18 billion. But the IMF continues to have powerful support. Even Martin Feldstein, an economist at Harvard, usually a critic of government spending and regulation, advocates a large role for the fund. He recently laid out a Rube Goldberg scheme for giving the IMF control over international capital movements. Mr. Feldstein would have the governments of emerging-market countries borrow from the IMF based on collateral. But the collateral would be a share of the foreign exchange earned by that country's exporters. Mr. Feldstein writes, "A country that borrows from this [international credit] facility would automatically trigger a legislated diversion of all export receipts to a foreign central bank like the Federal Reserve or the Bank of England with exporters then paid in a mixture of foreign exchange and domestic currency." In other words, Mr. Feldstein would have the U.S., U.K., and other governments nationalize assets of emerging economies' exporters -- hardly a recipe for improving those countries' economies.

## DIS-HARMAMENT

There are two main ways the U.S. government can avoid doing further harm. The first is to refrain from pushing for controls on international capital movements. The case for free movement of capital is similar to, and just as strong as, the case for free trade in goods. Governments that have successfully insulated their economies from international capital markets, as India did from the late '40s until 1991, also insulate them from growth. The countries that are hurting don't need less capital; they need more, just as the developing United States needed, and got, capital from Britain in the 19th century. With the IMF out of the picture, governments of poorer countries would be more likely to fix some of the problems -- high taxes, heavy regulation, threatened nationalizations, and controls on capital -- that scare investors away.

The other way the U.S. government can avoid doing further harm is by keeping trade open. The one bright spot in Asia's current situation, for example, is that it is still able to export goods to the United States and other countries. The Clinton administration, however, is working to dim that bright spot. At the November meeting of the Asia Pacific Economic Cooperation forum in Malaysia, Vice President Gore, after telling government officials from Asian countries that they should solve their economic problems by exporting more, warned them not to put this advice into practice with the United States. And President Clinton, only weeks after fretting about the world economic crisis, is trying to persuade the governments of South Korea and Japan to limit their countries' shipments of steel to the United States.

Many of the world's economies face serious problems, most of which are caused by government. Advocating more government regulation to solve the problems is like telling a suffering person to suffer more.