Abolish It

Allan H. Meltzer

Carnegie Mellon University, am05@andrew.cmu.edu

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II. Abolish It.

BY ALLAN H. MELTZER

What is the difference between, one, Oliver North funding the Nicaraguan opposition with money that Congress has not appropriated and, two, permitting a secretary of the U.S. Treasury to lend money to foreign governments without prior congressional appropriation? Yes, there are some differences. In the latter case, there is an alleged threat to financial markets requiring a rapid response. In the former case, an agent of the U.S. government supported an insurrection that Congress would not finance, supposedly in defense of national interest.

These two examples also have an unfortunate similarity. In both cases, monies are spent outside the budget process and without prior congressional approval. In the case of the 1995 Mexican loan, the Treasury even used the Exchange Stabilization Fund (ESF) after Congress had demonstrated its reluctance to approve the loan.

Those who approve of such actions apparently welcome their respective breach of standard, appropriation procedures. They argue that the stability of financial markets requires an ability to act promptly. But this justification and others like it could be said to apply to many government actions, national defense among them. It is an argument that uses the ends, such as the avoidance of financial crises, to justify the means. But the means are contrary to our principles, and for this reason alone the ESF should be ended.

The U.S. Constitution gives Congress the sole power to appropriate money. This bedrock principle of democratic government should not be put aside for the convenience of any administration in response to a real or imagined alarm. The Exchange Stabilization Fund should be closed. Its unencumbered balance should be used to retire government debt or to finance tax reduction.

Professor C. Randall Henning gives two principal reasons for why we should continue in this breach of budgetary principles. First, financial emergencies may arise suddenly which, if not treated promptly, can threaten the stability of the global financial system. Second, congressional committees have considered the matter on several occasions and, for the most part, permitted the ESF to continue its activities without congressional approval. They have responded to the breach of democratic control by making ESF transactions more transparent and more accountable to Congress. For example, Congress has required the quarterly publication of several ESF accounts, allowing members of the interested public to remain informed. But generally speaking, Congress has not pre-
vent the secretary from using the account except for a brief period from 1995 to 1997. Hence, it has de facto authorized ESF expenditures and accepted Treasury policy. That, in short, is the argument in its defense.

This is insufficient. There are many emergencies to which a government must respond. Congress appropriates funds to be used in later emergencies, based on the judgment of the president or his administration. The Federal Emergency Management Agency (FEMA) responds to natural and man-made disasters that cannot be foreseen. The Defense Department responds to unforeseen events and asks for a supplemental appropriation when its budget is overspent.

It may not be wise to budget for financial crises in the same way Congress budgets for FEMA, even though it is certainly possible to do so. We have found ways to assure that emergencies do not require us to abandon core democratic principles.

The present system of congressional oversight is not a substitute for budgeting. Congress receives thousands of reports and documents of all kinds. Unless some member takes special interest, there is little oversight. At present, there is no incentive for a member to use his or her time examining the ESF’s record.

Placing what are presently ESF expenditures into the budget process would introduce a systematic procedure in which those expenditures could be examined, even if that examination is cursory. The ESF would then be forced to compete with other uses of money, ensuring that some members of Congress would question the secretary’s use of funds. Congress, moreover, could withhold spending if dissatisfied. This system would not work perfectly, but it would work like the rest of the budget process. And I see no reason why Treasury expenditures should be different. The fact that Congress has permitted the ESF to avoid normal budget scrutiny thus far is not a reason for maintaining the present system.

In its early days between 1934 and the 1960s, the ESF was not very active. Its initial purpose was to intervene in the foreign exchange market after the devaluation of the dollar. President Franklin Roosevelt and Treasury Secretary Morgenthau believed that the British gained an advantage by using their Exchange Equalization Fund to intervene secretly. Roosevelt and Morgenthau wanted the same opportunity. They also wanted to change interest rates independent of Federal Reserve actions.

As is often the case in government, idle balances in moribund agencies attract precocious bureaucrats eager to manage current problems. So it is with the Exchange Stabilization Fund. The glibtest Washington lawyer would have difficulty demonstrating to an independent judge that the primary purpose of loans to Mexico in 1995 or to Asian countries in 1997-98 was to stabilize the U.S. dollar exchange rate, supposedly the main responsibility of the ESF.

The ESF’s early activities and original purpose bear no relation to recent uses of the ESF. Large loans at favorable rates to countries experiencing financial distress permitted short-term lenders to escape the full cost of their own misjudgments. Investors in equity or workers and businesses in the problem countries bore these costs.

Transmogrification of the ESF has not been in the public interest. Limiting losses to banks and short-term lenders reduces, and occasionally removes, the force of market discipline. It encourages, therefore, the very behavior that a rational policy would avoid — excessive reliance on short-term, dollar denominated, capital flows to finance long-term capital development. This policy is undesirable because it increases risk in the global financial system while reducing the cost borne by banks and other short-term lenders (moral hazard).

The Federal Reserve participates in these arrangements by lending money to the ESF. Since direct loans from the Federal Reserve to the Treasury are restricted in amount, the Federal Reserve calls this activity “warehousing” instead of lending. This subterfuge should also be outlawed.

Crisis will inevitably occur in domestic and international financial markets. Governments and central banks have a role in avoiding crises and safeguarding the domestic and international payments systems when crises occur. Professor Henning

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has not shown and, I venture, cannot show that these objectives require off-budget financing and a pool of money reserved for whatever purposes the secretary of the Treasury or the president choose to finance.

A recent House bill by Congressman Jim Saxton calling for greater regulation of the ESF is a step in the right direction. But the fact that it is only now we get this reform proposal, years after the fund’s purposes have been abused by secretaries of both parties, tells us much about congressional interest in the subject.

Abolition of the ESF would not only be better than the Saxton bill. It is the right thing to do.

JULY/AUGUST 1999 THE INTERNATIONAL ECONOMY 51