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THE INTERNATIONAL MONETARY FUND: OUTDATED, INEFFECTIVE, AND UNNECESSARY

INTRODUCTION

Founded 53 years ago in the turbulent era of the 1940s to stabilize the world economy, the International Monetary Fund (IMF)[1] has become outdated, ineffective, and unnecessary. Most of the economic conditions that led to the IMF's creation no longer exist; in addition, the Fund has failed to achieve most of its own newly defined roles, a preponderance of which merely duplicate the functions of other existing agencies and organizations.[2]

When the IMF was founded, economies around the world were in shambles following the Great Depression of the 1930s and the devastation of World War II. The poor economic policies pursued by many countries during the 1930s had left currency values uncertain, hindering trade. Those who created the IMF believed that it could help restore confidence in the world's currencies by establishing a specified value for each currency in relation to an amount of gold, a practice known as the gold standard. The IMF maintained these values by infusing money into world financial markets, but its efforts had mixed results.

When the gold standard was abandoned in 1971, it was replaced by a "floating" exchange rate system that allowed currencies to fluctuate in value. Bereft of its old mission, the IMF chose a new one: to act as a development bank for poor countries. The data for the past three decades, however, demonstrate conclusively that most of the less

1 The terms "IMF" and "Fund" are used interchangeably throughout this paper to refer to the International Monetary Fund.

2 For a comparable analysis of the World Bank, see Bryan T. Johnson, "The World Bank and Economic Growth: 50 Years of Failure," Heritage Foundation *Backgrounder* No. 1082, May 16, 1996.

developed countries receiving IMF loans have the same or lower per capita wealth today than they had before receiving these loans. Many actually are worse off economically:

- Of the 89 less developed countries that received IMF loans between 1965 and 1995, 48 are no better off economically today than they were before receiving IMF loans;
- Of these 48 countries, 32 are poorer than they were before receiving IMF loans; and
- Of these 32 countries, 14 have economies that are at least 15 percent smaller than when they received their first IMF loans.[3]

Many of the missions the IMF has chosen to undertake do not require any involvement by the Fund. Congress should examine the IMF's overall effectiveness in accomplishing its stated purposes, as well as its impact on poor and developing countries. If it does, it will find that the IMF more often than not has failed to advance the purposes for which it was founded and has contributed little to improving the economies of less developed countries. It is time for Congress to develop a legislative strategy to end the contribution to the IMF. Specifically, Congress should:

- **Refrain from funding any new IMF programs.** Because IMF programs have been largely ineffective, Congress should not consider requests from the Clinton Administration or from the IMF to fund such new IMF activities as the New Arrangements to Borrow (NAB) program. There are no guarantees that contributing additional U.S. tax dollars to put the IMF on "life support" will help recipient countries achieve long-run economic stability. The United States should not support any organization that lacks a viable purpose.
- **Seek a General Accounting Office (GAO) audit of IMF lending practices.** The GAO has conducted no audit of IMF finances in recent times. Congress therefore should call upon the GAO to audit these finances by focusing on the effectiveness of the Fund's lending practices and programs, as well as its loan performance.
- **Insist that the IMF be more open about its internal operations.** The IMF is a secretive organization, and details of its loans are not made public. Americans, however, deserve to know how their tax dollars are being spent. Congress should condition all future U.S. support on public access to IMF records and activities.
- **Require that the Administration report to Congress on the level of economic freedom in IMF recipient countries.** Specifically, the U.S. delegate to the IMF Executive Board should submit to Congress a report detailing the levels of economic freedom that exist in all countries receiving IMF loans.
- **Terminate all U.S. funding for the IMF after its current replenishment is completed.** When the current funding cycle is over, the United States will have committed almost $47 billion to the IMF, making it the Fund's largest single

3 See Appendix, Table 1, "Economic Growth Rates of Recipients of IMF Loans and Purchases."

contributor. Because the IMF relies on occasional replenishment of funds from donors, and since the last replenishment occurred in 1992, it is likely to seek a new replenishment soon. Congress should refuse to appropriate any additional funds for this outdated, ineffective, and unnecessary organization.[4]

WHY THE IMF IS OUTDATED

The IMF was founded in 1944 at a meeting of 44 countries at Bretton Woods, New Hampshire. It began operations in Washington, D.C., in 1946 with 39 member states and initial resources of $7.6 billion, contributed by 35 member states in 1945.[5]

Since then, the IMF has become a large multilateral organization with 181 member states. Its financial operations have been divided into three broad accounts: the General Department,[6] Administered Accounts,[7] and the Special Drawing Rights (SDR) Department.[8] Each account has its own specified purposes. Currently, IMF members provide over $220 billion a year to fund the organization's efforts.[9]

The IMF's record of success is spotty at best. There is scant evidence, for example, that it contributed to the stabilization of exchange rates after its creation. Moreover:

- **The international financial system has changed dramatically since 1944.** The IMF's original purpose was to maintain the stability of the world monetary system. It was established to promote worldwide economic growth and prevent the destabilizing effects that rapidly fluctuating currency values could have on the global economy. This required the IMF to buy, sell, and lend currencies of member states in order to maintain a set value for currencies in relation to the value of gold.

  The Fund set, or "pegged," currency values relative to gold in a manner that allowed for slight adjustment. For example, the Mexican peso might be set at 100 pesos per ounce of gold. If, however, Mexico's economic policies devalued the currency to 150 pesos per ounce of gold, the IMF would step in to buy pesos on

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4 See Scott A. Hodge, ed., *Balancing America's Budget* (Washington, D.C.: The Heritage Foundation, 1997), pp. 70–71.

5 David Driscoll, *What Is the IMF?* (Washington, D.C.: The International Monetary Fund, revised May 1995).

6 The General Department is the core of the IMF and handles the functions granted the organization in the original version of the Articles of Agreement. It includes the General Resources Account (GRA), which includes quota payments and borrowed resources such as the General Arrangements to Borrow (GAB), and the Special Disbursement Account, which administers the development funds of the IMF, known as the Structural Adjustment Facility (SAF) and the Enhanced Structural Adjustment Facility (ESAF). A proposed New Arrangements to Borrow (NAB) account will be placed under the GRA.

7 Periodically, the Fund establishes independent accounts (known commonly as Administered Accounts) for such specific purposes as technical assistance.

8 The Special Drawing Right (SDR) Department tracks all transactions and operations involving the SDR and is responsible for allocating and handling related duties, such as determining interest rates on the SDR. The SDR is an international reserve, interest-bearing asset created by the IMF in 1969, and is a unit of account on all IMF transactions. For SDR value determination, see Appendix, Table 2, "Number of Years Countries Received IMF Aid." Typically, an SDR is equivalent to about $1.50.

9 International Monetary Fund, *1996 IMF Annual Report*.

world financial markets, coordinating this action with instructions to Mexico on how to alter its economic policies accordingly. The IMF would increase the value of the peso artificially until it reached the 100 pesos per ounce of gold mark.[10] This system, called the gold standard, operated from the end of World War II until 1971, at which time the United States led the world in abandoning the gold standard.[11]

After 1971, instead of using a commodity like gold to "fix" exchange rates, the world allowed currencies to fluctuate in value when measured against other currencies. This process is known as a floating exchange rate system. With the gold standard eliminated, the IMF no longer had to maintain currency value in relation to gold. The main reason for its existence had disappeared.

- **The speed and growth of private currency transactions marginalize the effectiveness of institutions like the IMF.** Currently, unlike the period immediately following World War II in which private currency transactions were minimal, total foreign exchange transactions exceed $2 trillion a day.[12] Most of these transactions occur in the private sector outside the influence of the IMF. The Fund has about $220 billion at its disposal, but only part of this amount is readily available for financial transactions. Thus, its ability to influence exchange rate stability is negligible when compared to the sheer volume of financial transactions taking place throughout the world market.

  Moreover, not only are IMF resources dwarfed by those of the private sector, the IMF also lacks the ability to make the rapid responses necessary to affect exchange rate fluctuations. World currency values adjust on a minute-by-minute basis; the IMF's reaction time is measured in days, weeks, or even months. In many cases, by the time the IMF reacts, a country already will have suffered the consequences of its currency's collapse—a collapse caused by the government's own financial mismanagement. In some cases, the country actually may be recovering by the time the IMF acts. For example, the Mexican bailout of 1994 went into effect months after the fact, by which time Mexico's economy already was adjusting to the crisis and beginning to recover.

- **Private direct foreign investment eliminates the need for the IMF.** When the IMF and the World Bank were founded, little private investment flowed to the developing world. The delegates at Bretton Woods decided that multilateral institutions could change this by investing in less developed countries. The investment market has changed dramatically since 1944, however. According to the World Bank, private investment dwarfs public investment in developing countries and "account[s] for more than 80 percent [of $285 billion] of net long-term flows" in less developed countries. Private investment grew by 60 percent ($60 billion) in

10 The IMF generally allowed a slight fluctuation in the determined value of a currency and its worth in gold.

11 Kim R. Holmes and Thomas G. Moore, eds., *Restoring American Leadership: A U.S. Foreign and Defense Policy Blueprint* (Washington, D.C.: The Heritage Foundation, 1996), p. 121.

12 *OECD Letter*, Vol. 6, No. 2 (March 1997), p. 7.

1996, while public investment in the form of development assistance shrank by 23 percent ($12 billion).[13]

Although private investment is growing and investors are eager to enter less developed countries, they are experiencing competition for investment opportunities from public investment sources like the IMF. Directly following the collapse of the Soviet Union, the IMF and World Bank rushed into many newly free countries in Eastern and Central Europe, and private investors often found themselves competing with these large institutions for investment opportunities. In other words, the IMF and other public sources of public investment crowd out private investment.

Why the IMF Is Ineffective

Much about the international economy has changed since the end of World War II. In addition, much of what the IMF has done has resulted in failure. The IMF remains ineffective because:

- **IMF lending is more likely to create long-term dependency than to act as short-term assistance.** IMF lending, as defined by its articles, is supposed to be short-term. But according to economist Doug Bandow, most countries actually become long-term users of IMF loans.[14] A review of IMF lending activities reveals an increasing reliance on the Fund by less developed countries.

  For example, between 1965 and 1995, 137 countries received loans from the IMF. For 81 of these countries, the number of times they borrowed from the IMF between 1981 and 1995 increased an average of nearly 50 percent over the number of times they borrowed between 1965 and 1980. Only 44 countries reduced the number of times they borrowed during the same periods; 12 maintained activities at similar levels.[15] This means the IMF is extending loans to more countries with greater frequency than it has in the past, thereby involving greater total amounts of assistance than was the case before 1980.[16] Thus, the IMF has not been able to ensure that its loans to less developed countries are indeed in the short term. Instead, these loans have been more likely to create long-term dependence.

- **The IMF fails to encourage economic growth policies.** One of the IMF's goals was to encourage countries to adopt policies that foster economic growth. To accomplish this, the Fund recommends specific economic policies to which the recipient must adhere. This trade-off between policy change and assistance is called "conditionality."[17]

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13 David Wessel, "Flow of Capital to Developing Nations Surges Even as Aid to Poorest Shrinks," *The Wall Street Journal*, March 24, 1997, p. A5.

14 Doug Bandow, "A Record of Addiction and Failure," in *Perpetuating Poverty: The World Bank, the IMF, and the Developing World* (Washington, D.C.: Cato Institute, 1994), p. 19.

15 *Ibid.*

16 See Appendix, Table 2, "Number of Years Countries Received IMF Aid."

For example, in order to receive an IMF loan, a recipient country may be required to impose a host of specific economic policies, such as balancing its budget, devaluing its currency, maintaining tariff levels, or keeping tax rates high. Unfortunately, such requirements can prevent less developed countries from achieving significant, long-term economic reform. For example, the governments of many less developed countries maintain high levels of spending on unprofitable state-owned businesses, and this spending often creates huge budget deficits (as was the case in many Latin American economies during the 1980s). To qualify for loans from the IMF, therefore, a country may be required to reduce its budget deficit. The problem is that this country may try to comply by raising taxes, raising tariffs to increase revenues, or devaluing its currency by printing more money, thereby causing more inflation.

These policies seldom result in lower budget deficits or reduced international debt. Rather, they drive economies further into stagnation. Bolivia, for example, has received loans from the IMF every year except three between 1985 and 1995. Each time, it was supposed to reduce its budget deficit; instead, its budget deficit grew by over 8,000 percent from 1985 to 1993.[18] Moreover, Bolivia's external debt also soared.[19] Bolivia received its first IMF loan in 1968. In 1970, it had a total external debt of only $497 million; by 1993, that debt had swelled to over $4 billion.[20]

- **The IMF fails to enforce the requirements it imposes.** Even when the IMF is specific and actually manages to recommend economic policies that might encourage long-term growth, it is ineffective in holding countries accountable for violating these agreements. The IMF repeatedly has entered into agreements with countries that have a history of violating their contracts. Even when the Fund has established that a country violated reforms outlined in the loan agreement, it often will negotiate with that same country for a new or altered contract, and the loans continue.

For example, Peru entered into 17 different arrangements with the IMF between 1971 and 1977, and continues to receive money from the IMF today.[21] During the same period, Peru failed to meet the conditions for most of these agreements. Instead, the government continued its self-destructive economic policies. For example, in 1971, Peru's external debt was $2.7 billion; by 1977, Peru had signed 17 agreements with the IMF, yet its external debt had soared to over $9 billion.[22] Even though Peru failed to meet the conditions for these agreements, it continued to receive IMF funding.

17 Due to the IMF's secretive nature, it is impossible to determine the exact conditions of a specific IMF agreement with a given country. The IMF, however, is often frank about its requirement that recipients reduce the size of their budget deficits. See International Monetary Fund, "Ten Common Misconceptions About the IMF," 1988.

18 World Bank, *World Tables 1995*, Washington, D.C., 1995.

19 Total external debt includes debt to both public and private lenders.

20 World Bank, *World Tables 1995.*

21 Bandow, "A Record of Addiction and Failure."

22 World Bank, *World Tables 1989–90*, Washington, D.C., 1990.

- **The IMF has failed to help less developed countries improve economically.** In addition to weakening much of the world economy generally, IMF lending has hurt less developed countries specifically. For example, a review of IMF loan recipients indicates that most are no better off economically today (measured in per capita wealth) than they were before receiving these loans. In fact, many are poorer.[23] As noted earlier, 48 of the 89 less developed countries that received IMF money between 1965 and 1995 are no better off economically than they were before; 32 of these 48 countries are poorer than before; and 14 of these 32 countries have economies that are at least 15 percent smaller than they were before their first IMF loan or purchase.[24]

- **The economies of some recipient countries have performed especially poorly.** For example:

  ❶ From 1968 to 1995, Nicaragua received approximately $185 million in IMF loans. In 1968, per capita gross domestic product (GDP), measured in constant 1987 U.S. dollars, was $1,821; in 1993, it was only $816, or 55 percent less than it had been before Nicaragua received any loans.

  ❷ From 1972 to 1995, Zaire received approximately $1.8 billion in IMF loans. In 1972, per capita GDP, measured in constant 1987 U.S. dollars, was $683; in 1993, it was only $317, or some 54 percent less than it had been before Zaire received any loans.

  The inescapable conclusion is that IMF efforts to encourage economic growth have been dismal failures. Whether this has been caused by the recipient countries' poor adherence to IMF policy prescriptions or by flaws within these prescriptions themselves does nothing to alter this conclusion. Harvard economist Jeffrey Sachs believes both may be at fault: "Countries that comply with IMF/WB [World Bank] programs seem to outperform countries that do not. At the same time, however, even countries in compliance with IMF/WB programs experience poor to mediocre growth performance."[25]

WHY THE IMF IS UNNECESSARY

Even those who agree that the IMF is outdated and recognize its ineffectiveness may claim that there remains a need for an organization like the IMF. This is not the case. The Fund duplicates the duties and functions of other major international organizations, in addition to engaging in activities that are unnecessary:

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23 This calculation is based on comparisons of the gross domestic products (GDPs) of IMF recipients during their first year as recipients and the per capita GDPs of these countries in 1993. All figures are expressed in constant 1987 dollars. This figure includes countries whose economies grew less that 1 percent a year, expressed in per capita terms, for the period measured.

24 See Appendix, Table 1.

25 Jeffrey Sachs, "External Debt, Structural Adjustment, and Economic Growth," September 10, 1996, p. 2; paper presented at G–24 Research Group meeting in Washington, D.C., September 18, 1996.