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NO NEW FUNDING FOR THE IMF

Bryan T. Johnson
Policy Analyst

Brett D. Schaefer
Jay Kingham Fellow in International Regulatory Affairs

(Updating *Backgrounder* No. 1113, "The International Monetary Fund: Outdated, Ineffective, and Unnecessary," May 6, 1997.)

The International Monetary Fund (IMF) is outdated, ineffective, and unnecessary. Although it has spent some $170 billion on loans to developing countries since 1965, the IMF consistently has failed in its mission to help those countries grow economically. Disregarding this dismal record, however, the Clinton Administration is asking Congress to give the IMF $3.5 billion[1] in additional funding to support its New Arrangements to Borrow (NAB) program.[2]

The Administration's fiscal year 1998 budget request claims that the IMF needs the additional resources "in cases when a monetary crisis in any country could threaten the stability of the international monetary system." What this means is that the money will be used to bail out countries that adopt poor economic policies.[3]

In July, the Senate passed an appropriations measure (S. 955) that provides funds for the NAB. The House version (H.R. 2159), however, contains no such funding. A conference committee soon will begin work on reconciling the differences between the House and Senate bills.[4] Conferees should recognize the

1 The IMF does not use dollars in its accounts. Instead, it uses an IMF creation called a Special Drawing Right (SDR), which is composed of differing proportions of U.S. dollars, French francs, British pounds, German Deutsche marks, and Japanese yen. Typically, one SDR fluctuates in value from about $1.30 to $1.50. The actual U.S. commitment to the NAB would be SDR 2.46 billion, which is roughly equivalent to $3.5 billion.

2 Countries participating in the NAB include the United States, Germany, Japan, France, the United Kingdom, Saudi Arabia, Italy, Switzerland, Canada, the Netherlands, Belgium, Sweden, Australia, Spain, Austria, Norway, Denmark, Kuwait, Finland, Hong Kong, South Korea, Luxembourg, Malaysia, Singapore, and Thailand.

3 *Budget of the United States Government, Fiscal Year 1998*, Budget Volume, Executive Office of the President, Washington, D.C., 1997, p. 120.

4 The IMF approved the NAB on January 27, 1997. The organization must receive financial commitments from participating countries equal to 85 percent of the total (about $40 billion), however, before the IMF can utilize the NAB. Moreover, the IMF's five largest donors, including the United States, must agree to fund the NAB. This requirement grants Congress a veto over implementation of the NAB.

IMF's failure and not allow the conference version of the bill to include any funding for the NAB. The United States already has committed close to $47 billion to the IMF, making it the IMF's single largest donor. U.S. taxpayers should not be asked to contribute still more to bail out irresponsible countries.

There are several reasons why the IMF has failed and the NAB also can be expected to fail:

- **The IMF has shown little ability to help countries grow economically.** Despite claims to the contrary, the evidence shows that the IMF has failed in its primary mission: to help less-developed countries improve economically. Most IMF loan recipients are no better off economically today (measured in per capita wealth) than they were before receiving IMF loans. In fact, many are poorer.[5] Of the 89 less-developed countries that received IMF money between 1965 and 1995, 48 are no better off economically now than they were before receiving the loans. Of these 48, 32 actually are poorer; and of these 32, 14 have economies that are at least 15 percent smaller than they were before receiving their first IMF loan.[6]

- **IMF lending increases dependence, not self-sufficiency.** Although proponents of IMF funding argue that such aid can help countries avoid economic hardship, the fact is that it condemns them to long-term dependence by allowing them to avoid adopting sound economic policies. The evidence suggests, for example, that instead of becoming financially self-sufficient as a result of sound economic policies, countries actually become more dependent on the IMF over time. 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 by an average of 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 of time.

- **The NAB would increase the likelihood of financial crises.** Proponents of the NAB argue that the new fund would be instrumental in avoiding future fiscal crises like the Mexican peso crisis of 1994. It is more likely, however, that it would increase the number of crises, not reduce them. Countries dread financial crises because of the adverse consequences, such as inability to obtain credit and increases in capital flight, in which their citizens put their money in foreign bank accounts or assets abroad. This fear prompts them to avoid some of the politically attractive but unsound economic policies so popular in the developing world. The NAB works against this, however, by counteracting many of the consequences of a financial crisis. Once countries realize that the IMF will provide funds to offset the negative effects of a financial crisis, they become less likely to stick to politically unpopular, albeit sound, economic policies. Mexico is a good example. It has avoided adopting sound economic policies because its government knows the IMF will be there to bail it out in the event there is a financial crisis. Indeed, the United States and the IMF have bailed out Mexico four times since 1976, despite repeated assistance and admonitions that it get its economic house in order. If the IMF truly wishes to prevent fiscal crises, it should ensure that countries bear the full consequences of their actions by refusing to continue bailing them out.

Public investments like IMF loans go to poor countries regardless of whether they are making efforts to help their own economies. By contrast, a country must adopt sound economic policies if it is to attract private investment. If public investment programs like the NAB are not there to bail them out, countries will be forced to get off the public dole and implement policies that lead to long-term economic growth and stability.

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5 For a complete analysis, see Bryan T. Johnson and Brett D. Schaefer, "The International Monetary Fund: Outdated, Ineffective, and Unnecessary," Heritage Foundation *Backgrounder* No. 1113, May 6, 1997.

6 *Ibid.*

Policymakers would do well to reject the arguments for creating a new IMF program. Instead, they should realize that there is no evidence that these programs have any long-term positive effect on economic development. In fact, the evidence suggests quite the opposite: Recipients of such aid defer economic liberalization and become reliant on economic aid, which, in turn, has negative long-term effects on recipient countries.

The United States is the IMF's largest donor. There is no reason that U.S. taxpayers should be asked to provide additional money for an institution that has shown itself to be outdated, ineffective, and unnecessary.