Backgrounder

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Time for the International Monetary Fund and World Bank to Reconsider the Strategy for Millennium Development Goals

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Every September, the Board of Governors of the World Bank and the International Monetary Fund (IMF) meets to discuss their role, work, and strategy to reduce poverty and preserve global financial stability. The discussions this year will center on the Millennium Development Goals (MDGs) and the Monterrey Consensus to encourage developing countries to increase efforts toward poverty eradication.[1]

Everybody wants a world without extreme poverty, and policies in both rich and poor countries should advance that goal. However, the MDGs proposed at the U.N. Millennium Summit do not work to eradicate extreme poverty. Instead, they focus almost exclusively on redistributing wealth from rich to poor countries—a practice that promotes corruption and inefficiency—as opposed to encouraging poor countries to generate their own wealth.

Most economic development experts and even some government officials recognize that economic growth, not aid, generates wealth and provides resources for countries to develop and that private-sector participation in the economy largely drives economic growth and wealth creation. Therefore, removing obstacles to private-sector efforts—including excessive regulation, corrupt judicial systems, corrupt governments, high taxes, and government participation in the economy—is essential to promoting economic growth and, consequently, to eradicating poverty.

However, removing obstacles is a decision that must be undertaken by individual governments and

Talking Points

- The intention behind the MDGs is laudable: People desire a world without extreme poverty, lawlessness, hunger, and disease. However, the MDGs focus largely on alleviating symptoms of poverty, not its causes.
- Economic growth is the antidote to poverty. The keys to economic growth include an independent and effective judiciary, lowering taxes and excessive regulations, eliminating trade barriers, and government accountability to the people.
- A wealthier country has more resources to invest in education, health care, infrastructure, women's rights, and other things. The leaders of the country can then choose which social issues to address first, whether it is AIDS, child mortality, or literacy.
- If the World Bank and the IMF are to play a constructive role in eradicating poverty, their lending programs must give the right incentives to the governments of poor countries to promote economic growth as the solution to poverty.

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societies. The World Bank and the IMF can continue to give loans in stages in return for commitments from the recipient to adopt reforms—a policy known as conditionality—but reforms demanded up-front in return for money seldom materialize. In fact, this policy works against the promotion of comprehensive free-market policies. For that reason, the September meetings of the World Bank and the IMF in Washington, D.C., should focus on how to reform these institutions to give the right incentives to countries to open their markets to grow and develop.

The Bush Administration should support reforming these institutions' lending practices, using the recommendations of the congressionally mandated International Financial Institution Advisory Commission (IFIAC, or Melzer Commission) to establish a solid framework for reform. These proposed reforms of the IMF and the World Bank would maximize effectiveness, increase accountability for lending decisions, and limit harmful practices in the developing world.

A World Without Poverty

At the September 2000 U.N. Millennium Summit, U.N. member states adopted the Millennium Declaration. Eight goals were identified in the Millennium Declaration: eradicating hunger, achieving universal education, empowering women, reducing child mortality, improving maternal health, combating HIV/AIDS and other diseases, ensuring environmental sustainability, and developing a global partnership for development. The eighth goal includes commitments by developing countries to adopt sound economic policies and good governance and commitments by developed countries to increase aid, to cooperate in debt forgiveness, and to develop further an open, rule-based trading and financial system. To measure progress toward the eight MDGs, experts from the U.N. Secretariat, IMF, Organisation for Economic Co-operation and Development, and World Bank developed a set of targets and indicators.[2] (For a listing of the goals, targets, and indicators, see the Appendix.)

The intention behind these goals is laudable. Most people desire a world without extreme poverty, lawlessness, hunger, and diseases. The only problem is that the proposed MDGs focus largely on alleviating the symptoms of poverty, not the causes of poverty (e.g., closed markets and no rule of law).

For example, one of the four variables chosen to measure whether a country meets the second MDG goal—"achieve universal primary education"—is the literacy rate of 15–24 year olds. (See Appendix.) First, this measure may say little about the country's ability to develop. For example, according to the U.N. Human Development Indicators, Mongolia (a very poor country) has a literacy rate of 98 percent among adult males,[3] slightly greater than Hong Kong's literacy rate. Yet Hong Kong's per capita gross domestic product (GDP) is 59 times greater than Mongolia's. Reading, writing, being healthy, living longer, having untouched forests, and having access to contraceptives are useless to the poor if they lack the economic opportunity to put their skills and assets to work.

Second, while some may argue that measuring the literacy rate or longevity is an indirect way of measuring whether the underlying causes of poverty are being addressed, this is not necessarily true. Some poor or corrupt (or both) countries have high literacy rates (e.g., Mongolia, Argentina, and Cuba), yet large shares of their populations live in poverty.

More to the point, by measuring the eradication of poverty in ways that are not correlated to the causes of poverty, the MDG initiative diverts the world's efforts in the wrong direction. Claiming that reducing poverty is about more reading, fewer diseases, a better environment, and more rights for women will direct the world's resources to aid these

1. The Monterrey Consensus is a strategy adopted in 2002 in Monterrey, Mexico.
2. United Nations Department of Economic and Social Affairs, Statistics Division, "Millennium Development Goal Indicators Database," July 30, 2005, at *unstats.un.org/unsd/mi/mi_goals.asp* (September 16, 2005).
3. United Nations Development Programme, "Human Development Index," in *Human Development Report 2005*, at *hdr.undp.org/statistics/data/indicators.cfm?x=3&y=1&z=1* (September 15, 2005).

activities, which promise little long-term improvement for the poor. Rather than ameliorating poverty's harmful effects, a far better approach would be to focus on eradicating its roots by designing assistance programs that expand the wealth of all people, thereby enabling them to secure a better education, improved health care, a cleaner environment, and greater protection of human rights.

At the same time, by targeting aid at the symptoms of poverty, the MDG approach sends the message to poor countries that they do not need to change their restrictive economic policies that prevent people from growing wealthy. As a result, the money (in the form of aid) only obscures the real problems, perpetuating and even increasing poverty. In this way, the MDGs become only an excuse to support the redistribution of wealth from the rich to the poor, which succeeds only in supporting corrupt politicians in poor countries and bureaucrats in Washington while failing to alleviate poverty significantly.

Economic growth is the antidote to poverty, and the keys to economic growth include an independent and effective judiciary, lowering taxes and excessive regulations, eliminating trade barriers, and maximizing accountability to citizens. If the World Bank and the IMF are to play any constructive role in the development process, they must provide the right incentives to poor countries to take the necessary steps to ensure the essentials for economic growth. Aid can still help countries with relatively better policies to cope temporarily with some of the consequences of poverty. However, countries with a weak rule of law, corruption, heavy state economic intervention, and little private-sector participation in the economy do not provide conditions for long-term economic growth. Thus, they will not reduce poverty even if they receive economic assistance.[4]

The *Index of Economic Freedom*, published annually by The Heritage Foundation and *The Wall Street Journal*, provides a framework for visualizing how policy-generated obstacles limit economic growth. Simply put, the *Index* measures how constrained ordinary people are in engaging in all levels of economic activity—from starting a business to opening a bank account to using a credit card, from buying groceries to fixing their homes to being able to obtain good health care, from finding a job and buying a car to sending their children to school to counting on sound law enforcement and courts to protect their personal liberties and private property. The fewer obstacles to these activities that exist, the more people can participate in the economy and achieve with their own efforts by working, investing, saving, and consuming. The freer the economy, the more it can expand, putting money in the pockets of millions of people and thus increasing the wealth of the country.

A wealthier country has more resources and greater incentives to invest in education, health care, infrastructure, arts, culture, women's rights, and many other things that it chooses to support. The leaders of the country and society can choose which social issues to address first, whether it is AIDS, child mortality, or literacy. Economic growth gives people the income to decide which development issues to address and in what priority. Universal education may be a priority in Sri Lanka, but AIDS may be a priority in Malawi. When countries generate wealth on their own, the development process is, as it should be, controlled by those who will benefit from it.

From this perspective, the strategy of the MDGs should be to gradually eliminate obstacles to economic growth. For example, using the *Index* as a guideline, MDG strategies would include:

- Trade policy (eliminating tariffs and non-tariff barriers in both rich and poor countries);
- Fiscal burden (reducing taxes and government expenditures);
- Government consumption (reducing the amount of business in the government's hands);
- Monetary policy (keeping inflation low and money stable);

4. For more information on The Heritage Foundation's proposal for reform of the World Bank, see Ana Isabel Eiras and Brett D. Schaefer, "A Blueprint for Wolfowitz at the World Bank," Heritage Foundation *Backgrounder* No. 1856, June 2, 2005, at *www.heritage.org/Research/TradeandForeignAid/bg1856.cfm*.

- Banking and finance regulations (reducing regulations that affect the functioning of domestic and foreign private banks and the stock market);
- Capital flows and foreign investment regulations (reducing regulations that affect the flow of capital across countries);
- Wage and price regulations (eliminating subsidies and freeing prices and wages);
- Protection of property and individual rights and enforcement of contracts and laws; and
- Reduction of regulations that govern starting a business, including labor and environmental regulations.

As these variables improve, the barriers to private participation in the economy decrease, creating greater opportunities for individuals to make money because working and conducting business become less difficult. People have the same desires, skills, and abilities as they did when they were poor, but the opportunities to employ them become easier to find. As a result, the country becomes increasingly wealthy and developed.

Whither the World Bank and the IMF?

Ideally, the World Bank, the IMF, and development agencies in general would not exist. Without them, poor countries would need to implement sound policies to grow further and generate income for the people and the government. However, these international institutions are unlikely to disappear, so reforming their lending practices is the next best approach to eradicating poverty. In the upcoming annual meetings, these institutions should discuss how to reform their practices to help countries to grow and develop.

The World Bank. The World Bank should help in a way that gives the poorest countries' leaders incentives to adopt policies that promote economic freedom and strengthen the rule of law. One alternative is to emulate the Millennium Challenge Account (MCA), a new U.S. government approach that makes assistance available only to countries that govern justly, invest in their people, and encourage economic freedom. In other words, aid is awarded only to countries with relatively good policies.

Aid to these countries should be provided in the form of performance-based grants rather than loans. In 2000, the International Financial Institution Advisory Commission proposed a system of performance-based grants for the World Bank. The bank would contract with private-sector businesses, charities, universities, and other appropriate entities to fulfill measurable objectives (e.g., the number of vaccines given to children, the number of children fed at a local village, and the number of patients cared for in a small town). In this way, the bank could exert greater control over a project's execution, monitor results more easily, reduce the opportunities for corruption, and ensure desired outcomes.

Of course, this approach would have the biggest impact only if the World Bank actually stops giving aid to countries that stubbornly cling to policies that impede economic growth and development. The challenge for the World Bank is to draw a hard line, no matter how poor the country, and stop lending where reform goes nowhere. Not only will this provide greater assurance that the assistance will be more effective, but it will also provide incentives for other nations to adopt policies that increase their opportunities for economic growth and development.

The IMF. The IFIAC report also laid out a basis for reforming IMF lending practices. In the report, the commission advised that a reformed IMF would have the unique responsibilities of:

1. Acting as a quasi-lender of last resort to *solvent* emerging economies,
2. Collecting and publishing financial and economic data from member countries and disseminating the data in a timely and uniform manner, and
3. Providing advice (but not imposing conditions) relating to economic policy.[5]

5. Allan H. Meltzer, *Report of the International Financial Institution Advisory Commission*, March 2000, at *www.house.gov/jec/imf/meltzer.pdf* (September 15, 2005), and in Spanish at *www.heritage.org/Research/InternationalOrganizations/EFP00-04.cfm* (September 15, 2005).

The commission also laid out the rules for IMF lending. It advocated a system of preconditions that emerging economies must meet to qualify for an eventual loan. The preconditions include:

- Freedom of entry and operation for foreign financial institutions. The purpose of this precondition is to increase portfolio diversification in order to limit corrupt lending by local banks to favored clients and reduce risk.
- Adequately capitalized commercial banks. The purpose of this precondition is to "establish market discipline in the domestic financial sector and protect the soundness of financial institutions."
- Regular publication of the maturity of outstanding sovereign and guaranteed debt and off-balance-sheet liabilities. The purpose of this precondition is "to encourage prudent behavior, safety and soundness."
- Establishment of a sound fiscal policy. The purpose of this precondition is "to assure that IMF resources would not be used to sustain irresponsible budget policies."[6]

These preconditions would reduce both future dependence on loans and the likelihood of future crises because they would create an environment that promotes the efficiencies and benefits of open markets.

The Bush Administration should support the reform of World Bank and IMF lending practices and use the IFIAC report to establish a solid framework for reform. The reforms would maximize their effectiveness, increase accountability for their lending decisions, and limit their current harmful influence (despite their best intentions) in the developing world.

Conclusion

The upcoming annual meeting of the World Bank and the IMF will likely center on the MDGs and the Monterrey Consensus, which aim at eradicating extreme poverty by 2015. However, the MDGs proposed at the U.N. Millennium Summit almost exclusively target the symptoms of poverty instead of its roots, calling for a redistribution of wealth from rich to poor countries in the form of aid—a practice that promotes corruption and does not foster economic growth. Therefore, the overall goal of reducing extreme poverty by 2015 is not likely to be achieved. Aid-supported programs remove the incentives for poor countries to generate their own wealth.

If the World Bank and the IMF are to play any constructive role in achieving this poverty-eradication goal, their lending programs must give the right incentives to the governments of poor countries to promote economic growth as the solution to poverty. Specifically, their programs must encourage poor countries to uphold an independent, effective judiciary, to lower taxes and excessive regulations, to eliminate trade barriers, and to be more accountable to their citizens.

The Bush Administration should support reforming the World Bank and the IMF. The reforms should maximize their effectiveness, increase accountability for their lending decisions, and give incentives to the leaders of poor countries to take the future of their people in their own hands.

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6. *Ibid.*, pp. 42–43.

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A Complete Listing of the Goals, Targets, and Indicators for MDGs

Goals and Targets	Indicators
Goal 1: Eradicate poverty and hunger	
Target 1: Halve, between 1990 and 2015, the proportion of people whose income is less than $1 per day.	1. Proportion of population below $1 (purchasing power parity or PPP) per day. *1a. Poverty headcount ratio (percentage of population below national poverty line). 2. Poverty gap ratio (incidence times depth of poverty). 3. Share of poorest quintile in national consumption.
Target 2: Halve, between 1990 and 2015, the proportion of people who suffer from hunger.	4. Prevalence of underweight in children (under five years of age). 5. Proportion of population below minimum level of dietary energy consumption.
Goal 2: Achieve universal primary education	
Target 3: Ensure that, by 2015, children everywhere (boys and girls alike) will be able to complete a full course of primary schooling.	6. Net enrollment ratio in primary education. 7a. Proportion of pupils starting grade 1 who reach grade 5.[1] *7b. Primary completion rate. 8. Literacy rate of 15–24 year olds.
Goal 3: Promote gender equality and empower women	
Target 4: Eliminate gender disparity in primary and secondary education preferably by 2005 and in all levels of education no later than 2015.	9. Ratio of girls to boys in primary, secondary, and tertiary education. 10. Ratio of literate women to men, ages 15–24. 11. Share of women in wage employment in the nonagricultural sector. 12. Proportion of seats held by women in national parliament.
Goal 4: Reduce child mortality	
Target 5: Reduce by two-thirds, between 1990 and 2015, the under-five mortality rate.	13. Under-five mortality rate. 14. Infant mortality rate. 15. Proportion of one-year-old children immunized against measles.
Goal 5: Improve maternal health	
Target 6: Reduce by three-quarters, between 1990 and 2015, the maternal mortality ratio.	16. Maternal mortality ratio. 17. Proportion of births attended by skilled health personnel.
Goal 6: Combat HIV/AIDS, malaria, and other diseases	
Target 7: Halt and begin to reverse the spread of HIV/AIDS by 2015.	18. HIV prevalence among pregnant women. ages 15–24. *19. Condom use rate of the contraceptive prevalence rate.[2] 19a. Condom use at last high-risk sex. *19b. Percentage of 15–24 year olds with comprehensive correct knowledge of HIV/AIDS.[3] 20. Ratio of school attendance of orphans to school attendance of non-orphans, ages 10–14.
Target 8: Halt and begin to reverse the incidence of malaria and other major diseases by 2015.	21. Prevalence and death rates associated with malaria. 22. Proportion of population in malaria-risk areas using effective malaria prevention and treatment measures.[4] 23. Prevalence and death rates associated with tuberculosis. 24. Proportion of tuberculosis cases detected and cured under directly observed treatment short course (DOTS).

A Complete Listing of the Goals, Targets, and Indicators for MDGs (cont.)

Goals and Targets	Indicators
Goal 7: Ensure environmental sustainability	
Target 9: Integrate the principles of sustainable development into country policies and program and reverse the loss of environmental resources.	25. Proportion of land area covered by forest. 26. Ratio of area protected to maintain biological diversity to surface area. 27. Energy use (kilograms of oil equivalent) per $1 GDP (PPP). 28. Carbon dioxide emissions (per capita) and consumption of ozone-depleting chlorofluorocarbons (ODP tons). *29. Proportion of population using solid fuels.
Target 10: Halve, by 2015, the proportion of people without sustainable access to safe drinking water and basic sanitation.	30. Proportion of population with sustainable access to an improved water source, urban and rural. 31. Proportion of population with access to improved sanitation, urban and rural.
Target 11: Achieve, by 2020, a significant improvement in the lives of at least 100 million slum dwellers.	32. Proportion of households with access to secure housing.
Goal 8: Develop a global partnership for development	
Target 12: Develop further an open, rule-based, predictable, nondiscriminatory trading and financial system. (This includes a commitment to good governance, development, and poverty reduction—both nationally and internationally.)	*Note: Some of the indicators listed below will be monitored separately for the least developed countries, Africa, landlocked countries, and small island developing states.*
Official Development Assistance (ODA)	
	33. Net ODA total and to the least developed countries, as a percentage of OECD/DAC donors' gross national income.
Target 13: Address the special needs of the least developed countries. (This includes tariff-free and quota-free access for exports, enhanced program of debt relief for heavily indebted poor countries (HIPC), and cancellation of official bilateral debt, and more generous ODA for countries committed to poverty reduction.)	34. Proportion of bilateral, sector-allocable ODA of OECD/DAC donors for basic social services (basic education, primary health care, nutrition, safe water, and sanitation). 35. Proportion of bilateral official development assistance ODA of OECD/DAC donors that is united. 36. ODA received in landlocked countries as a proportion of their gross national incomes. 37. ODA received in small island developing states as a proportion of their gross national incomes.
Market Access	
Target 14: Address the special needs of landlocked countries and small island developing states (through the Program of Action for the Sustainable Development of Small Island Developing States and 22nd General Assembly provisions).	38. Proportion of total developed country imports (by value and excluding arms) from developing countries and from least developed countries that is admitted free of duty. 39. Average tariffs imposed by developed countries on agricultural products and textiles and clothing from developing countries. 40. Agricultural support estimate for OECD countries as a percentage of their gross domestic product. 41. Proportion of ODA provided to help build trade capacity.
Debt Sustainability	
Target 15: Deal comprehensively with the debt problems of developing countries through national and international measures to make debt sustainable in the long term.	42. Total number of countries that have reached their HIPC decision points and number that have reached their HIPC completion points (cumulative). 43. Debt relief committed under HIPC initiative. 44. Debt service as a percentage of exports of goods and services.

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A Complete Listing of the Goals, Targets, and Indicators for MDGs (cont.)

Goals and Targets	Indicators
Other	
Target 16: In cooperation with developing countries, develop and implement strategies for decent and productive work for youth.	45. Unemployment rate of 15–24 year olds, male, female, and total.[5]
Target 17: In cooperation with pharmaceutical companies, provide access to affordable, essential drugs in developing countries.	46. Proportion of population with access to affordable, essential drugs on a sustainable basis.
Target 18: In cooperation with the private sector, make available the benefits of new technologies, especially information and communications.	47. Telephone lines and cellular subscribers per 100 population. 48a. Personal computers in use per 100 population. 48b. Internet users per 100 population.

[1] An alternative indicator under development is "primary completion rate."
[2] Among contraceptive methods, only condoms are effective in preventing HIV transmission. Since the condom use rate is only measured among women in union, it is supplemented by an indicator of condom use in high-risk situations (Indicator 19a) and an indicator of HIV/AIDS knowledge (Indicator 19b). Indicator 19c (contraceptive prevalence rate) is also useful in tracking progress in other health, gender, and poverty goals.
[3] This indicator is defined as the percentage of 15–24 year olds who correctly identify the two major ways of preventing the sexual transmission of HIV (using condoms and limiting sex to one faithful, uninfected partner), reject the two most common local misconceptions about HIV transmission, and know that a healthy-looking person can transmit HIV. However, since there are currently not a sufficient number of surveys to be able to calculate the indicator as defined above, UNICEF in collaboration with UNAIDS and WHO have produced two proxy indicators that represent two components of the actual indicator. They are the percentage of women and men ages 15–24 who know that "consistent use of condom" can protect a person against HIV infection and the percentage of women and men ages 15–24 who know that a healthy-looking person can transmit HIV.
[4] Prevention is measured by the percentage of children under age five sleeping under insecticide-treated nets. Treatment is measured by percentage of children under age five who are appropriately treated.
[5] An improved measure of this target is under development by the International Labour Organization.

* These indicators have been proposed as additional MDG indicators, but have not yet been adopted.
Source: The World Bank.