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## Aid to Ukraine Should Not Be Held Hostage by IMF Politics

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The Obama Administration is insisting that before Congress can support courageous, Westward-looking Ukrainians, it must first reduce the power of the United States at the International Monetary Fund (IMF).[1] The White House wants Congress to attach its approval of an IMF governance "reform package" that has been pending for three years to any legislation providing urgently needed U.S. financial assistance to Ukraine. That certainly gives a new and strange meaning to the concept of "IMF conditionality."

As Heritage reported in January,[2] there are significant "moral hazard" issues in the 2010 IMF reform package that must be considered on their own merits. Decisions about the reform package should not be taken in the crisis atmosphere surrounding the situation in Ukraine. Congress should insist that the Obama Administration remove the unnecessary linkage between adoption of urgently needed IMF assistance to Ukraine and the larger questions raised by the IMF reform package.

**Ukraine's Economic Problems Are Deep.** At the root of the problems in Ukraine are the lingering effects of the corrupt and inefficient post-Soviet economic systems in the heavily industrialized eastern, Russian-speaking areas and throughout the country.

Despite repeated calls to do so, many of these problems in Ukraine have never been seriously addressed, nor have enough necessary reforms been adopted in the 20-plus years since the fall of the Soviet Union.

These failures can be seen in Ukraine's score in The Heritage Foundation/*Wall Street Journal 2014 Index of Economic Freedom*: 49.3.[3] That means its economy remains in the bottom *Index* category ("repressed")—even lower than Russia. Ukraine is the 155th freest out of 178 countries ranked in 2014 worldwide; it is last among the 43 countries measured in the European region. After former Ukrainian President Viktor Yanukovych took office in 2010, the country registered steadily deteriorating scores on property rights, corruption, financial freedom, and investment freedom.

An IMF program for Ukraine can use these *Index of Economic Freedom* categories as a guide to shape the many reforms and conditions that will be needed to help put the Ukrainian economy on a sustainable path to recovery.

For example, the Ukrainian currency (the hryvnia) needs to be permitted to float so as to avoid further depletion of the nation's foreign currency reserves. Another huge drain on resources can be plugged by phasing out the unsustainable and wasteful system of state energy subsidies, which amount to more than 7 percent of Ukraine's gross domestic product.

**The 2010 IMF Reform Package: Wholly Unrelated to Ukraine.** In 2010, the IMF board, with support from the Obama Administration, proposed a series of reforms that would increase the voting

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power of certain emerging-market nations and double the amount of member countries' national "quota" contributions that are the primary source of funding for IMF loans.[4]

The U.S. has the largest quota of any country in the world and also the largest single-nation voting share (16.75 percent). It has been the only country in the world with veto power at the IMF. Due to the constitutional role of Congress and U.S. veto power, this IMF reform package must therefore be approved by Congress before it can go into effect.[5]

The reform package would change the rules for election of the IMF executive board, and the U.S. would lose the right it has heretofore enjoyed to appoint its own representative to the executive board—and that is where all the power is at the IMF.[6]

The reform package would also reduce U.S. control over certain "supplementary" IMF funds that can be tapped when demand for IMF resources is particularly strong, such as during major financial crises. There are two supplementary funds: the New Arrangements to Borrow (NAB) and the General Arrangements to Borrow. The U.S. currently funds the largest portion of the NAB—about $103 billion, or about 18 percent.[7]

It is clear that the U.S. has benefitted—and will continue to benefit—from the existence of the IMF. In fact, Ukraine is almost a textbook example of a nation that needs a lender of last resort, the sort of situation for which the IMF was created more than 70 years ago.

On the other hand, many conservatives have rightly pointed to the IMF as an enabler of moral hazard. They are concerned that American tax dollars are being used for IMF programs that bail out bad decisions by other governments that follow reckless fiscal and monetary policies (e.g., the flawed policies that Ukraine pursued under Yanukovych until 2011 when the IMF ended its previous program for the country).

**Congress's Role.** Congress should:

- Refuse the Obama Administration's attempt to link urgent assistance to Ukraine to approval of the IMF governance reform package that has been pending for three years,
- Insist that the 2010 reform package be revised so that the U.S. retains the unilateral right to appoint its own representative to the executive board, and
- Demand the abolition of the NAB supplemental facility so that it cannot be used in the future as an additional source of potentially morally hazardous lending during the next "crisis."

Meanwhile, President Obama should be leading efforts by Western countries to provide immediate help to the people of Ukraine through existing international financial institutions (e.g., the IMF), appropriate bilateral aid, and increased private investment.

**The Best Prescription: Economic Freedom.** The IMF has been functioning effectively for the three years since the IMF governance reforms were proposed in late 2010. There is no reason why the U.S. government cannot immediately put together an emergency aid program for Ukraine (loans, grants, and technical assistance) by repurposing existing congressional development assistance appropria-

1. Press release, "Fact Sheet: International Support for Ukraine," White House, March 4, 2014, http://www.whitehouse.gov/the-press-office/2014/03/04/fact-sheet-international-support-ukraine (accessed March 5, 2014).
2. See James M. Roberts, "Congress Should Block the Morally Hazardous IMF 'Reform' Package," Heritage Foundation *Issue Brief* No. 4124, January 14, 2014, http://www.heritage.org/research/reports/2014/01/us-congress-should-block-the-hazardous-imf-reform-package.
3. Terry Miller, Anthony B. Kim, and Kim R. Holmes, *2014 Index of Economic Freedom* (Washington, DC: The Heritage Foundation and Dow Jones and Company, Inc., 2014), pp. 439–440.
4. Rebecca M. Nelson and Martin A. Weiss, "IMF Reforms: Issues for Congress," Congressional Research Service *Report for Congress*, February 1, 2014, http://www.fas.org/sgp/crs/misc/R42844.pdf (accessed January 9, 2014).
5. International Monetary Fund, "IMF Quotas," October 1, 2013, http://www.imf.org/external/np/exr/facts/quotas.htm (accessed January 9, 2014).
6. International Monetary Fund, "IMF Executive Directors and Voting Power," updated March 6, 2014, http://www.imf.org/external/np/sec/memdir/eds.aspx (accessed January 9, 2014).
7. International Monetary Fund, "IMF Standing Borrowing Arrangements," October 1, 2013, http://www.imf.org/external/np/exr/facts/gabnab.htm (accessed January 9, 2014).

tions without the need for Congress to first adopt the IMF reform package.

In any case, the pursuit of prudent, free-market, and pro-economic growth policies—those potentially at risk from IMF-funded moral hazard—remains the best prescription for all IMF member countries and requires no IMF resources to follow. These core principles are the foundation of the *Index of Economic Freedom*.

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