ON THE WRONG TRACK:

A Summary Assessment of IMF Interventions in Selected Countries

January 1998

1025 Vermont Avenue • Suite 300
Washington, DC 20005 • USA
Tel: 202 783-7400 • Fax : 202 783-0444
E-mail: foedc@igc.org

927 Fifteenth Street, NW • 4th Floor
Washington, DC 20005 • USA
Tel: 202 898-1566 • Fax: 202 898-1612
E-mail: dgap@igc.org • Web: www.igc.org/dgap

CONTENTS

Overview

As Asian economies continue to unravel, investors have looked to the International Monetary Fund for guidance as to whether prospective economic performance warrants their continued involvement in those countries. With a war chest of funds and a staff of neoliberal economists at its disposal and the power and influence of Northern governments and financial markets behind it, the IMF not only sets the standards for such performance, it also forces compliance with the carrot of emergency funding and the stick of discouraging the flow of private-sector and other public-sector financing. When the going gets rough under IMF tutelage, the refrain is always the same: deepen the reforms with more of the same medicine.

But how good has IMF advice been, and how accurate a guide has the Fund's stamp of approval been for investors? To start, investments in IMF-touted emerging-market countries over the past five years have performed no better than much safer investments at home, and the Fund failed to warn of the two big crashes of the decade -- Mexico and East Asia. In fact, right up to the currency and stock-market collapses, the IMF was praising these countries as models of economic success and rationality. Perhaps blinded by its own prescriptions (and the interests of investors) to open these -- and other -- economies before the necessary institutional, financial and social infrastructure was in place, the Fund has consistently failed to recognize, or at least publicly acknowledge, the underlying weaknesses in these economies and its own contribution to the debacles.

Friends of the Earth and The Development GAP, with the support of the Charles Stewart Mott Foundation, have engaged partners in six countries to assess, through short case studies, IMF performance in a representative cross-section of economies. Drafts of four of the studies -- Mexico, Senegal, Tanzania and Hungary -- have been completed, and summaries are attached; the profiles of the Philippines and Nicaragua are still in progress. The cases paint a consistent picture of an institution bent on fully opening economies to foreign investors on advantageous terms at almost any cost -- the destruction of domestic productive capacity and local demand, growing poverty and inequality, the deterioration of education and health-care systems, and, as has been seen, a dangerously expanding vulnerability of these economies themselves to external forces beyond their governments' control.

What is clear from these studies, and from IMF intervention across the board, is that the Fund's loan conditions -- which have gone beyond tight monetary and fiscal policies and other stabilization measures to include the liberalization of trade, direct investment and financial capital flows, as well as the dismantling of labor protections and economic infrastructure that supports small producers -- have been imposed without linkage to a long-term development strategy aimed at sustainable and equitable growth and economic competitiveness.

In Mexico, a program of rapid trade liberalization, economic and financial-sector deregulation and large-scale privatization, accompanied by policies that undercut local demand and production, had created a growing current-account deficit well before the December 1994 collapse of the peso. The increasing dependency on foreign capital inflows required to finance the deficit eventually led to massive capital flight and the crisis. Subsequent IMF conditions attached to the bailout of foreign investors, which in essence deepened the reform program while ignoring its underlying weaknesses, caused an economic depression, pushing millions of farmers out of agriculture, bankrupting thousands of small businesses, and drastically slashing jobs and wages. Likewise, in Nicaragua, financial-sector deregulation, narrowly focused and without adequate prior institutional reform, has directed capital toward short-term, high-interest deposits and away from productive investment, particularly the activities of small-scale producers in both the agricultural and manufacturing sectors.

In Africa, the IMF record has been even worse. Tanzania, forced to adopt a program of trade liberalization, devaluation, tight monetary policy and the dismantling of state financing and marketing mechanisms for small farmers, has experienced expanding rural poverty, income inequality and environmental degradation amidst growing agricultural export trade. Food security, housing conditions and primary-school enrollment have fallen while malnutrition and infant mortality have been on the rise. The country, under Fund supervision, is today more dependent than ever on foreign aid. Across the continent, Senegal, an IMF pupil for 18 years, has experienced declining quality in its education and health-care systems and a growth in maternal mortality, unemployment and the use and abuse of child labor. Official IMF statistics underestimate the real inflation rate faced by most of the population, while economic growth has not effectively reached the poor. As women constitute the vast majority of the poor and depend more on social services, experience lower education and literacy rates, and are less likely to receive support for their agricultural (food-crop) activities than are men, they have suffered disproportionately under the adjustment program.

With the IMF as its guide, Hungary has led the reform process in Eastern Europe, similarly liberalizing its trade regime, tightening its money supply and selling off assets (on questionable terms) to foreign interests with little concern for the productive contributions of workers and domestic producers in the "real" economy. As a result, an increasing portion of resources are being directed away from investment in human capital and infrastructure formation toward unemployment benefits and payments to wealthy bondholders. A more fragmented and troubled society has emerged in which other big losers include: the elderly, who often cannot afford the cost of medicines or home heating; pensioners, whose stipends will further decrease; gypsies, who are losing access to jobs and public housing; youth, who face decreased access to education and employment, particularly in rural areas; and children, who, for the first time, are experiencing malnutrition as poverty expands in Hungary.

The IMF claims that it is not a development assistance agency and its track record proves its point. Yet, while destroying the basis for sustainable, equitable and stable development around the globe with the imposition of both stabilization and adjustment measures, the Fund has also greatly increased the economic vulnerability of nation after nation. By opening the door prematurely to fickle and unregulated foreign capital flows, by liberalizing trade and investment regimes and pushing up interest rates to attract bondholders without adequate support for local production, by developing cheap production bases for foreigners and export at the expense of underpaid and undereducated work forces, domestic demand and the natural environment, and by rewarding speculators instead of financing critical social investments and equilibrium, the IMF has demonstrated both its biases and its ignorance of local conditions. It should be neither a guide for the market nor a dictator of national development programs. At this point in history, the less influence, the less money, the less power it has, the better.

The Micro-Economic Impact of IMF Structural Adjustment Policies in Mexico

by Alejandro Nadal, El Colegio de México/Equipo PUEBLO

Summary

As a result of a series of agreements reached between the Mexican government and the International Monetary Fund (IMF) since the mid-1980s, a set of policies aimed at trade liberalization, large-scale privatization and general economic deregulation was implemented. As a result, the Mexican economy became increasingly dependent on capital inflows (particularly short-term portfolio investments) to finance its growing current-account deficit. These inflows contributed to the overvaluation of the peso in the early 1990s, and, when the international community judged the current-account deficit to be unsustainable, $5 billion in capital fled the country. The value of the peso plummeted, interest rates soared, and by early 1995 the Mexican economy was plunged into its worst economic depression in 60 years, the effects of which are still being felt by the large majority of Mexicans -- despite claims of recovery by the IMF and U.S. and Mexican policymakers. Furthermore, Mexico's financial infrastructure remains precariously unstable.

As a result of the conditionalities in its 1982, 1986 and 1989 agreements with the IMF, the Mexican government implemented rapid trade liberalization and deregulation of its capital account (direct and portfolio investment, as well as the removal of controls on the repatriation of profits), leading to rapid capital inflows. These policies, however, were not accompanied by any long-term strategy to develop the country's competitiveness, so they simply opened the door to increased financial vulnerability. In fact, just as these open-economy policies were launched, investments in education, research and development and infrastructure were cut.

A key element of the adjustment program carried out in Mexico was the establishment of "Pactos" among representatives of government, businesses and the official labor federation, through which incomes policies were imposed on the economy. Through the Pactos, the IMF demands for wage restraint were effected, as wage increases were indexed to "expected" levels of inflation. Between the implementation of the first Pacto in December 1987 and May 1994, the minimum wage increased by 136 percent, while the cost of a basic basket of consumer goods rose by 371 percent. Workers' compensation in the manufacturing sector decreased by 30 percent between 1993 and 1995.

Mexican agricultural producers were expected to respond to new economic signals coming from the liberalized agricultural markets. The same adjustment program that liberalized trade, however, required cuts in credit, technical assistance and subsidized inputs. As a result, millions of farmers, particularly poor farmers producing food for the local economy, have been pushed out of agriculture altogether. Some 1.8 million peasants have left home in the three years since the crash in search of work in the United States, in Mexico's overcrowded cities and in the maquila sector.

The 1995 adjustment program imposed by the IMF and the U.S. Treasury as a condition for the bailout of those who had invested in Mexico, required, among other things, the maintenance of high interest rates. Large interest payments, along with cheap imports, the economic slowdown and a severe drop in demand resulting from the cuts in real wages, have forced over 20,000 small and

medium-scale businesses, or a third of Mexico's enterprises, into bankruptcy. As economic activity came to a standstill and demand was cut, orders were canceled and plants operated at less than minimum levels. Idle capacity in many branches of the manufacturing sector increased to 70 percent; to date, the large majority of these companies have not recovered.

Two million jobs were lost in the wake of the crash. While the Mexican government announced at the end of 1997 the creation of a million new jobs, a large portion of these are part-time and unstable. Today, nearly ten million Mexicans, or one-third of the economically active population, is unemployed or in precarious jobs. The only part of the economy that grew during 1997 was the maquila sector. The number of people living in poverty in Mexico has grown to 40 million, and nearly one half of those are in extreme poverty. The minimum wage now buys only a third of what it did in 1981. This substantial reduction in the standard of living has been felt most by women and children. Economic insecurity is pervasive, and crime is skyrocketing.

This state of affairs has rocked Mexico's financial sector. Overdue loans increased by three percent in 1997, pushing the value of such loans to more than one half of the portfolio of Mexican banks. With the banking sector teetering, the government, with the help of the international financial institutions, has implemented a massive bank bailout that has reached 46 billion dollars, or some 12 percent of Mexico's GDP. This compares with six percent allocated to education and social development combined. The World Bank has acknowledged that, while investors have covered only a small part of the losses, the burden of the crisis has fallen mainly on taxpayers.

Despite the lessons that should have been learned from the country's economic collapse, the IMF and the Mexican government continue to depress the economy and allocate resources to production for export to the U.S. market by a relative handful of Mexican and foreign firms. Interest rates remain high -- stifling the efforts of most producers -- in order to attract portfolio investment and repay the IMF and foreign bondholders. With a structural reliance on productive imports, an expanding debt burden, a renewed dependence on speculative capital on the horizon, and a continued neglect of the country's disintegrating productive capacity and social infrastructure, Mexico, with the help of the IMF, is rapidly recreating the conditions that existed in 1994.

Gender and Social Dimensions of IMF Policies in Senegal

by Yassine Fall, Partners for African Development and Economic Justice

Summary

An IMF stabilization program began in Senegal in 1980 and a longer-term structural adjustment program in 1986. While the IMF has touted Senegal as a success story because of its increased growth rate, lower inflation and smaller budget deficit, in fact the country has failed to achieve a stable, sustainable growth that effectively reaches the poor. Unemployment and hunger have increased and are widespread. The quality of social services, such as education and health, including infant and maternity care, has declined, hitting women, who make up the vast majority of the poor, particularly hard.

The IMF pushed for a major devaluation of the Franc CFA for nearly ten years and ultimately made the devaluation a condition for any further assistance to the CFA countries, including Senegal. In January 1994, the Franc CFA was devalued by 50 percent. In theory, imports, which thus became more expensive, would lose out in the domestic market to locally produced goods. In practice, however, the prices of local goods have increased faster than those of imports, as many locally made products consist in good part of imported inputs. Also, the prices of basic services such as water, electricity, transportation and telecommunications have increased under the adjustment program.

While the IMF has cited lowered inflation as an achievement of the adjustment program, official statistics do not adequately capture increases in the prices of basic goods. The consumption basket used to calculate inflation was established in 1967 and has never been revised to reflect changing spending patterns. For example, under the adjustment program families bear a greater share of the costs of health, education, housing and transportation than in the past, but the official inflation figures give those costs very little weight.

As a result of the devaluation and the elimination of key government programs, few farmers are able to afford agricultural inputs such as seeds and fertilizers. The support that is provided has been directed to the cultivation of groundnut and other export crops, to the detriment of production of such basic food crops as vegetables, corn and millet. In 1990, 33 percent of the population was classified as hungry. By 1992, this figure had increased to 40 percent. In 1996, the Senegalese Ministry of Planning estimated that 22 percent of children suffer from chronic malnutrition.

It is highly unlikely that the government will be able to carry out its announced plans to reduce illiteracy and to lessen the differences in education and literacy rates between men and women, given the budgetary constraints of the adjustment program. In 1995, 67 percent of all Senegalese adults and 77 percent of women were illiterate. Within the eligible age group for elementary schools, only 55 percent of girls and 64 percent of boys are enrolled. Just 23.8 percent of the students in technical training schools are girls. Under the adjustment program, however, the government has cut education expenditures. The average number of students per elementary class has increased from 55 in 1985 to 62 in 1993. Teachers' unions have denounced the declining quality of education, as school equipment, tables, chairs, teaching materials and buildings are in short supply.

Health-care expenditures have also been falling under the adjustment program. In 1990, the government spent just 2.3 percent of GDP on health care, far below the nine percent minimum level recommended by the World Health Organization (WHO). The number of people per hospital increased from 404,818 in 1988 to 494,000 in 1995, more than three times the WHO norm. Women have suffered disproportionately from these cuts. By 1988, 52.2 percent of women were receiving no prenatal care, and maternal mortality was 750 per 100,000 live births. By 1993, this figure had risen to 1,200 per 100,000.

Unemployment has also increased during the adjustment period. In Dakar, joblessness has increased from 25 percent in 1991 to 44 percent in 1996. The use of child labor has intensified in order to supplement the reduced incomes of parents laid off in the name of budget equilibrium. According to the ILO, ten percent of Senegalese children are providing paid labor. A survey by the Senegalese Office of Forecasts and Statistics found that 82 percent of girls work in agriculture or domestic tasks. More and more little girls are deprived of their right to education and are sent to work in families as housekeepers, working long hours under very stressful conditions, often exposed to sexual or other physical abuses.

The Impact of IMF Structural Adjustment Policies on Tanzanian Agriculture

by Ross Hammond, in association with the Evangelical Lutheran Church of Tanzania

Summary

The IMF structural adjustment program in Tanzania began in 1986, with additional agreements signed in 1987, 1991 and 1996. As agriculture is by far the most important sector in terms of employment (over 80 percent), contribution to GDP (over 60 percent) and foreign-exchange earnings (75 percent), much of the IMF's policy interventions have focused on that sector. While agricultural production and exports have increased since the adjustment program began, so have rural poverty, income inequality, food security, malnutrition and environmental degradation. As a result, Tanzania has become ever more dependent on foreign aid.

The key elements of the adjustment program in Tanzania have been devaluation, cuts in subsidies, and trade liberalization. These measures have dramatically increased the prices of inputs for the production of both food and export crops. Between 1989 and 1992, for example, the price of fertilizer increased between 183 and 412 percent, depending on the type. At the same time, producer prices for food crops have decreased. Between 1985 and 1991, these prices fell for maize (30 percent), paddy (11 percent), cassava (32 percent), sorghum and millet (40 percent) and beans (6 percent). Since state marketing and pan-territorial pricing programs were ended, small farmers in remote areas have found it especially difficult to market their crops. The World Bank reports that, while "...rich farmers negotiate selling prices with private traders, the poor sell in smaller quantities and at lower prices." Despite these problems, the IMF's Policy Framework Paper for 1995/96 to 1997/98 focuses on improving "marketing efficiency" rather than on fairness.

Consistent with the demand of the IMF for a tight monetary policy, the government has sought to lower inflation and increase the domestic savings rate by raising interest rates. This has greatly increased the budget deficit, since a large portion of domestic debt is owed by government-owned parastatals. It has also contributed to raising informal-sector interest rates as high as 100 percent. The high interest rates, coupled with the privatization of the Co-operative and Rural Development Bank, has meant that credit for small-scale agriculture has virtually disappeared. According to the IMF, the private (mostly foreign) banks now operating have restricted their activities "mostly to trade financing in Dar es Salaam, avoiding for the most part domestic lending activities."

Under the IMF program, food security in Tanzania has diminished considerably. In 1996, Tanzania faced a severe food shortage affecting 19 districts in eight regions. Analysts attributed the poor food situation in part to the removal of subsidies on fertilizers. The World Bank's 1996 Country Economic Memorandum reported that food intake levels have stagnated, due to the "limited accessibility to food and the rising cost of living." Currently, over 40 percent of all Tanzanian children under five years of age have stunted growth and 90 out of 1,000 children born in the country

die before their first birthday. Despite modest gains in real GDP growth, the World Bank reports that such basic human-welfare indicators as infant mortality, nutrition, housing conditions, and primary school enrollment "appear to be stagnant or worse, compared to the level of the 1970s or early 1980s."

The problem of food insecurity has been exacerbated by the high and worsening degree of income inequality in Tanzania. The IMF's program has failed to benefit those who most need an increase in income, and in fact have worsened the economic situation for Tanzania's poor. Between 1983 and 1991, the better off saw their incomes from agriculture rise by 279 percent, while the poor and very poor experienced income decreases of 42 and 60 percent, respectively. In 1983, the average adult equivalent of income for the richest income group was 24 times greater than that for the poorest group. By 1991, that figure was 1,454 times greater due to the large proportion of the population with zero or even negative incomes. Those living in households with income below the "hard core" poverty line (over eight million people in 1991, or 42 percent of the population) had lower incomes in 1991 than in 1983.

Environmental degradation has increased since the adjustment program began, as people become more desperate to produce on any lands available. Between 1980 and 1993, one-quarter of the country's forest area was lost, exposing even greater areas of land to wind and water erosion. Deforestation is currently occurring at a rate of two percent a year. Forty percent of this loss is a result of land clearing for cultivation. Another cause of deforestation is the cutting of wood to cure tobacco. Tobacco cultivation has been encouraged under adjustment in order to increase foreign-exchange earnings.

Under the adjustment program, Tanzania has become more dependent on food imports and on foreign aid than ever before. Aid as a percentage of GDP rose from seven percent in 1985 to 61 percent in 1992. In 1993, it covered two-thirds of imports, 40 percent of recurrent budget expenditures and 60 percent of the development budget.

The Impact of IMF Structural Adjustment Policies: The Case of Hungary

by Károly Lóránt, Association of Hungarian Economists

Summary

Hungary became a member of the IMF in 1982 and has since implemented a series of structural adjustment agreements. Over time, neoliberal economists came to occupy key positions in the National Planning Ministry, the Finance Ministry, and the National Bank, establishing the so-called "financial government". The goals of the IMF and the government during the 1980s were to establish a controlled market economy and to open the country to foreign investors. In the 1990s, price controls have been lifted, trade has been liberalized and the National Bank has gained broad autonomy in implementing monetary policy. In this decade, wages, employment and services have declined for the population generally and have fallen markedly for a number of major sectors, while the economy has contracted and stagnated.

The economy shrank 20 percent between 1989 and 1993, and the current-account balance and fiscal deficits deteriorated significantly. The current-account deficit was financed mainly by the sale of state property. With that property for the most part now sold off, Hungary's current account has been brought into balance through the attraction of both foreign portfolio investment by offering high interest rates and of direct investment by multinational firms in Hungary's customs-free zones, creating considerable financial uncertainty.

The main goal of fiscal policy under the IMF program has been to reduce the budget deficit, but this has created a vicious circle. That deficit originated from rapidly growing interest payments on government debt and has increased from between 2.0 and 2.5 percent of GDP in the late 1980s to 10 percent by 1997, of which interest payments constitute one third. This has contributed to inflation and to reductions in demand and production. Subsidies and social programs were also cut (although unemployment benefits have increased). Therefore, an increasing portion of public resources is being redirected away from investments in human capital and infrastructure formation to unemployment benefits and payments to wealthy bondholders.

The main goals of the IMF-promoted monetary policy have been to curb inflation and to improve the current-account balance. Beginning in 1992, this policy was tightened considerably, pushing interest rates well above profit rates in industry, thus discouraging productive investment and preventing any consistent economic growth. This problem has been exacerbated by the privatization process, in which many firms were artificially "damaged" on the books so they could be sold at lower prices. Some were purchased by Western European competitors and dismantled so as to open a market for the former under the newly liberalized trade regime. Industrial output fell by 34 percent between 1992 and 1996 and then rebounded slightly on the back of export sales from Hungary's customs-free zones, which have few linkages to the Hungarian economy as a whole.

Real wages fell by 24 percent between 1989 and 1996. The average net wage in 1996 was US$200. The highest wages are found in the financial-intermediary sector (US$320), while the lowest are found in the textile and building industries and in health care (US$150). Meanwhile, unemployment increased from zero percent in 1989 to 13 percent by 1993 and currently hovers around ten percent. Poverty has increased, as well, to the degree that child malnutrition, which was previously unknown in Hungary, has become a new and growing phenomenon.

The adjustment program has had a particularly deleterious effect on certain population groups. Young people, for example, have decreased access to higher education, not only because of the introduction of tuition fees, but also because their parents are now unable to finance the costs of food, lodging, textbooks and other expenses. At least 20 percent of those completing school are unable to find employment in urban areas; in rural areas the rate is much higher. The high unemployment rate has also hit gypsies especially hard, as the majority live in the northeast region of the country, where they were formerly employed as unskilled laborers in heavy industry or in the construction trades. Many have also lost access to public housing as a result of the adjustment program.

Retired people have suffered, as well. The real value of pensions has decreased even more than wages. Furthermore, the IMF has insisted on pension reforms that include a flat rate for all elderly people, an earnings-related mandatory retirement savings program, and a voluntary pension plan. Unions and retired peoples' organizations maintain that this will result in further decreases in pensions for all except those with more than 40 years of permanent employment. At the same time, changes in the health-care system mandated under the adjustment program have resulted in increasing costs of medicines. Increases in heating costs have meant that many old people cannot pay for heat, and there have recently been cases of the elderly freezing to death in their apartments.