**TESTIMONY BY STEPHEN HELLINGER, PRESIDENT
THE DEVELOPMENT GROUP FOR ALTERNATIVE POLICIES
(THE DEVELOPMENT GAP)**

**REGARDING**

# CONGRESSIONAL FUNDING OF

# THE INTERNATIONAL MONETARY FUND

**PRESENTED TO**

## THE SUBCOMMITTEE ON GENERAL OVERSIGHT AND INVESTIGATIONS
## COMMITTEE ON BANKING AND FINANCIAL SERVICES
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Although the International Monetary Fund was established with the specific mandate to help stabilize currencies for the purpose of facilitating international trade, it has assumed over time the ever expanding role of dictating overall national economic programs around the globe, particularly in the countries of the South and Central Europe.

With a war chest of funds and a staff of orthodox economists at its disposal and the power and influence of Northern governments and financial markets behind it, the IMF not only sets the standard for the performance of national economies, it also forces compliance with its economic prescriptions. It uses both the carrot of its own funding and the stick of discouraging the flow of private-sector and other public-sector financing.

But how good have IMF economic advice and prognoses been? In the cases of the two big crashes of this decade -- Mexico and East Asia -- it certainly failed on both accounts. In fact, right up to their financial collapses, the IMF was praising these countries as models of economic success and rationality. Blinded by its commitments to a rigid and often inappropriate economic orthodoxy and to opening economies on behalf of international investors, the Fund has consistently failed to recognize, or at least publicly acknowledge, the underlying weaknesses in these and many even less developed economies, including the absence of the financial, commercial, productive and social infrastructure needed to engage successfully in the global economy.

As will be detailed in this testimony, the actions of the IMF have had a devastating impact, wherever it has operated, on small businesses and farms, employment, wages, poverty, local demand, income distribution and women, as well as on local productive capacity, the environment and foreign debt. The case of Mexico is particularly instructive in demonstrating how IMF policies plant the seeds of crisis in countries made highly vulnerable to the vagaries of global markets and then increase that vulnerability and intensify poverty and social disintegration as part of bailout packages. It is now the turn of Thais, South Koreans and Indonesians to watch the IMF turn financial crises into economic ones in their countries as it insists on the implementation of programs that bail out and open new opportunities for foreign investors while strangling local economies. Who will be next?

The Development GAP urges Members of Congress to familiarize themselves with the destructive effects that IMF policies have had on domestic economies and the quality of life in countries across the Third world and Central Europe -- and with the destabilizing consequences of these impacts -- before moving to consider allocating any additional resources, much less the $18 billion currently requested by the Clinton Administration, to the Fund.

The Development GAP has worked on IMF and World Bank issues since its establishment in the mid-1970s. After consulting for five years at the Bank, our organization, in collaboration with colleagues around the world, has monitored the impact of the economic-policy conditionalities of these two institutions in dozens of countries over the past two decades. Today, The Development GAP heads a global citizens' initiative taken with the president of the World Bank to review jointly the effects of these policies in ten countries and to provide the people of these nations the opportunity to help formulate more realistic economic programs that better fit local conditions and meet local needs.

**Holding the IMF Accountable**

Far from preventing and resolving crises elsewhere in the world, the IMF -- if it were to have additional funding at its disposal without first undertaking fundamental and far-reaching reforms -- would continue to generate, and intensify, the very problems that the Congress is attempting to address. These effects include the suppression of local demand and the attendant reduction in imports from the United States, as well as an increase in production for export, at lower prices, to the U.S. market. Just as the Asian crisis followed on the heels of Mexico's economic collapse, ever more profound crises lie ahead unless and until the Congress takes decisive action to circumscribe the actions and influence of the international financial institutions.

Appropriating funds for the IMF on the condition that it subsequently implement prescribed reforms has proven to be an ineffective means of inducing change in the Fund. History is littered with IMF failures to adopt reforms requested by Congress once it has received its funding. The only way to hold the Fund accountable, therefore, is to treat it as it does client governments: by requiring compliance with a set of established conditions *before* funding is provided and by tranching the release of those funds to ensure continued compliance with the imposed conditions. If Congress is to transform the IMF into an agent of sustainable and equitable economic progress, these conditions must include, at a minimum, the following requirements:

> * that the Fund make its operations, its internal and external decisionmaking processes, and its relationships and agreements with governments transparent tolegislatures and the general public in its member countries;
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> * that the Fund democratize and enhance the policymaking process by consultingregularly with the major sectors of civil society in each country in which it

operates and by integrating their input systematically in all program and policy negotiations;

* that the Fund ensure conformance with internationally recognized labor rightsas set forth by the International Labour Office;

* that the Fund help, first and foremost, to develop strong domestic economies with expanding productive capacity supported by rising wages and localdemand and by local savings and affordable credit so as to enable countries to engage on more equal terms in the global economy while reducing their dependence on foreign capital;

* that the Fund's Board reject its Interim Committee's recommendation to expand the institution's mandate to "make the liberalization of capital movements oneof the purposes of the Fund" and, rather, submit to the U.S. Treasury a plan for regulating the volatile global flow of speculative capital, while establishing a program for strengthening the capacity of local financial institutions to regulate and manage short-term capital flows at the national level; and

* that the Fund submit to the U.S. Treasury proposals for the creation of a privately capitalized risk-insurance fund that would eliminate the need for IMF-funded bailouts of private-sector investors and banks.

There is plenty of time for the IMF to comply with these conditions and to demonstrate that it can act as a transparent and democratic institution and a responsible lender. The Fund does not presently face a liquidity problem, and the international commercial and investment banks have demonstrated in Asia their ability to ease local liquidity crises by rolling over outstanding loans.

**IMF Intervention and Economic and Social Decline**

A review recently completed by The Development GAP of data from a number of official and academic sources on a total of 83 Third World countries that have received substantial IMF financing during the past 20 years confirms what people living around the world under IMF-financed programs already know first hand. In most of the countries studied, unemployment increased, real wages fell, income distribution became more unequal, poverty rose, food production per capita declined, external debt grew, and social expenditures were cut during the years between 1978 and 1997 in which these countries received resources from the Fund's General Resources Account (GRA) and/or loans from its Structural Adjustment Facility (SAF), Enhanced Structural Adjustment Facility (ESAF) and/or Trust Fund.

**** Unemployment has increased.*** During the years 1978-1995, of the 43 countries in our review for which the International Labour Office (ILO) has published statistics, 31 countries, or 72 percent, suffered a rise in unemployment during years of IMF funding. The Central African Republic, for example, experienced an approximate 20-percent increase in unemployment between the years 1985 and 1994, a period in which that country received considerable IMF support. Ghana suffered an even greater increase -- nearly 56 percent -- between 1986 and 1994, during which time the country was continually under SAF or ESAF arrangements. The Inter-

American Development Bank (IDB) reports that more than one half of the 20 Latin American countries for which it has official data experienced rising unemployment in the 1980s and '90s, during which time these countries have received considerable and ongoing IMF lending. These figures probably underestimate the problem. For example, in Mexico, a major recipient of IMF financing, a person working one day per month is considered employed. If one were to add the number of workers employed under precarious circumstances to the official unemployment total, only two thirds of today's economically active Mexican population of nearly 30 million workers would be considered to be securely employed.

**** Real wages have fallen.*** Despite a scarcity of wage data and inconsistencies in that which is available, the overall picture is clear and discouraging. Employed individuals in the majority of developing countries for which there is data have seen their real wages decrease. According to the ILO *World Labour Report*, 18 countries since 1980 have experienced a decrease in real manufacturing earnings during years in which they received considerable financial support from the IMF. Comparatively, only ten have seen any clear improvement in earnings. Legal minimum-wage rates show the same trend, with 15 countries experiencing a real decline, while only six show improvement.

According to a study by British economist Frances Stewart, average real wages declined in 26 out of 28 African countries, and the real minimum wage fell in 22 out of 29 countries, during the 1980s, a period of considerable IMF funding. The United Nations Development Programme (UNDP) reports that real earnings per employee fell, between 1980 and 1992, in nine of the eleven IMF-funded Latin American and Caribbean nations for which it has data. This decline was more than two percent on average over that period for Venezuela, Brazil, Uruguay, and Argentina. Furthermore, the real minimum wage is lower today than it was in 1980 in 17 of the 19 nations studied by the IDB. Fernando Leiva, a Chilean economist, relates that even in Chile, a country which is often portrayed as a model of economic development, 45.5 percent of those employed in 1994 received wages inadequate to cover the basic needs of an average-sized household. And it would have taken a drop of only three U.S. dollars in monthly per capita income, according to Leiva, for another 742,000 Chileans to be cast below the poverty line.

**** Inequality in income distribution has worsened in many countries.*** In IMF-supported countries, particularly in Latin America and the Caribbean, inequality in income distribution has worsened considerably. Statistics from the Economic Commission on Latin America and the Caribbean (ECLAC) bear proof of this growing disparity: in seven of the 11 cases for which data is available between 1979 and 1992, the percentage of wealth controlled by the poorest 20 percent of the populations fell.

In Mexico, income and wealth distribution had deteriorated significantly even before the economic crash of 1994-95; between 1984 and 1994, the share of national income received by the top ten percent of the Mexican population increased from 34 percent to 41 percent, while the share held by the poorest 40 percent fell from 13 to 11 percent. In El Salvador, during the high-growth period of 1988-1991, the share of national income received by the poorest ten percent decreased by almost one half and that received by the poorest 40 percent dropped by one third; according to the research center, FUNDE, all the population deciles but the highest two experienced a decline, while the top decile's income increased dramatically from 27 to 38 percent. In Chile, the richest 20 percent of Chilean households further expanded their share of national income during the first half of this decade; in contrast, the poorest 20 percent suffered a loss of their income share, with the poorest ten percent suffering an absolute decrease in income of 6.6 percent between 1992 and 1994 alone (Leiva). In Argentina, the percentage of poor people has nearly doubled, while the share of national income received by the richest ten percent of households has increased sharply over the past two decades.

**** Poverty persists.*** The impact of the IMF on poverty is equally disheartening: poverty has either increased or remained the same in the majority of Third World countries during the years of IMF support. Data published for the period 1980 to 1990 by the ILO show that rural poverty increased in 21 of the 34 IMF-supported countries for which statistics exist and that the situation in urban areas was only marginally better. In Ghana, for example, which has been receiving IMF loans throughout most of the 1980s and '90s (under SAF and ESAF arrangements since 1987), rural poverty increased from 37 percent in 1980 to 54 percent in 1990. In fact, in the two regions with the highest incidence of income poverty -- Sub-Saharan Africa and South Asia -- poverty is increasing in both absolute and relative terms, according to the UNDP's 1997 *Human Development Report*, and the majority of countries in these regions have received substantial IMF funding. The IMF has not spared the middle-income nations, either. For example, Mexico, recently on the verge of achieving "developed country" status, saw the number of its people living in extreme poverty jump from 11 to 15.8 million during the decade ending in 1995.

**** Food production per capita has declined.*** A majority of developing countries implementing IMF programs experienced a negative average annual growth rate in food production per capita between the years 1979 and 1993. According to the World Bank's 1995 *World Development Report*, 39 of the 69 countries for which there is data suffered from declining food production. For most poor countries, a scarcity of foreign exchange and other vulnerabilities mean agricultural self-reliance is more a necessity than a choice. Sustained food production is essential to preventing a rise in hunger.

**** Debt burdens have grown heavier.*** Development in most countries in the South has been made even more difficult by the increase in foreign debt that they have experienced while the IMF has involved itself in the management of their economies. A Development GAP study of 71 countries that have adopted structural adjustment programs prescribed by the IMF and the World Bank shows a positive correlation between the number of years that a country has an adjustment program in place and an increase in debt as a percentage of GNP. The average (mean) increase in the debt/GNP ratio among these countries was 49 percent, with the typical (median) country experiencing a 28 percent increase (Marek and Dawkins Scully, January 1998).

The World Bank's own figures show that 63 out of 69 countries have experienced an increase in their external debt while implementing SAPs. On average, debt increased nearly 78 percent in these 63 countries during those years, 1980-95, in which SAPs were in place. These figures are all the more striking in light of the fact that it has been a principal goal of the IMF to have countries put their internal and external accounts in balance and decrease their foreign obligations. The record also seriously calls into question the long-term effectiveness of any debt-reduction plan that conditions country participation on the implementation of Fund-promoted adjustment programs.

**** Budget allocations to social services have decreased.*** Because they must service their debt in order to receive further international assistance, these countries are forced to divert a large portion of their resources from investment in productive and social sectors. A study by Stewart shows a large difference between adjusting and non-adjusting countries in budget-allocation ratios. A rise of 8.4 percent in the share of expenditures going to interest payments occurred in the adjusting countries, accompanied by a decrease in the portion going to social sectors. In the non-adjusting group, the opposite is true.

According to a United Nations Conference on Trade and Development (UNCTAD) study of ten African Countries implementing SAPs, the mean level of government expenditure on education fell from 3.3 percent during 1981-1986 to 2.6 percent during 1987-1990. "[T]he failure to protect health and educational budgets from general fiscal retrenchment," says UNCTAD in its *Least Developed Countries 1995 Report*, "was a serious policy error in the design of SAPs. Cut-backs of this nature inevitably have adverse consequences for social welfare and these in turn impinge on the economic productivity of human resources."

**A Closer Look at the IMF's Influence**

The IMF's role in the economic and social decline of African and other Southern economies is the focus of detailed country studies commissioned by Friends of the Earth and The Development GAP. This past year, we engaged partners in six countries to assess, through short case studies, IMF performance in a representative cross-section of economies, including Tanzania, Senegal, Hungary, the Philippines, Nicaragua and Mexico. The studies 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 most recently and dramatically in East Asia, 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 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.

For example, Tanzania, which was forced by the Fund 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 and 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.

Similarly, in Nicaragua, IMF-prescribed financial-sector deregulation, narrowly focused and without adequate prior institutional reform, has stimulated the flow of capital to short-term, high-interest deposits at the expense of productive investment, particularly the activities of small-scale producers in both the agricultural and manufacturing sectors.

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.

### Failure of the Mexico Bailout

Since financial crisis hit Asia in late 1997 and the International Monetary Fund intervened in Thailand, Indonesia and then South Korea, the 1995 bailout of Mexico and of those investors holding short-term Mexican bonds has been held up by U.S. and Mexican policymakers as a successful model to replicate. Indeed, a picture has been painted of a rapidly recovering Mexican economy that is regaining the status of a fundamentally healthy emerging market that it occupied in many quarters until the peso and the economy collapsed at the end of 1994.

The reality, as noted above, is quite different. From the perspective of most Mexicans, who continue to suffer under the intensified adjustment program on which the bailout was conditioned, and of Mexican economists and citizens' organizations that relate to the real economy, their country remains in serious economic straits. The best that can be said is that the level of suffering and economic insecurity of the majority of the population has stabilized for the moment. At the same time, however, the core of Mexico's economy has been gutted, the same conditions that created the 1994 crash are reappearing, and the country has been destabilized from the streets of Mexico City to the mountains of Chiapas.

*** *Domestic productive capacity has collapsed.*** Between 1995 and 1997, more than a third of Mexico's businesses -- over 20,000 small and medium-sized enterprises -- declared bankruptcy. With domestic demand still low, interest rates still high and barriers to imports falling, there has so far been no recovery in this core sector of the Mexican economy.

*** *Massive unemployment persists.*** Two million people lost their jobs in the economic collapse, leaving one third of the economically active population of nearly 30 million workers unemployed or in precarious jobs. Some 1.8 million peasants have been forced to leave their homes in search of work. The absence of unemployment benefits has exacerbated this crisis. The government recently announced the creation of a million new jobs in 1997, but with anyone working one day per month classified officially as employed, it is difficult to determine the significance of this figure.

*** *Wages have fallen precipitously.*** Over the past three years, real wages, already perilously low, have declined by almost 25 percent. Since 1982, wages have lost more than 66 percent of their purchasing power.

*** *The banking system remains virtually insolvent.*** Only periodic injections of fresh capital from the Mexican government keep the banks afloat. Since the collapse of the economy, the government has invested the equivalent of more than US$46 billion in the banking system, an amount equivalent to 12 percent of the country's GDP and twice the amount spent by the government on education and social development combined. More than 50 percent of the banks' portfolios is overdue, as most businesses and consumers cannot repay their loans.

*** *The current account is once again in deficit.*** Trade deficits in recent months have been worse than expected. Mexico's overdependence on oil exports has been highlighted by the sharp fall in international oil prices. Just as significant is the fact that export manufacturing, and particularly the maquiladoras, is virtually the only sector that has shown any growth since 1994, and this sector is now highly dependent on the import of capital goods and components for assembly. This structural problem, which was brought on by economic liberalization, contributed to the 1994 crisis and is now serving to generate a similar financial hazard.

*** *Interest payments on heavy foreign borrowing have exacerbated the current account deficit.*** In order to pay back the U.S. Treasury its bailout loan, the Mexican government borrowed extensively in international private markets. It offered rates of five percent above what is normal, taking on extensive obligations. Today, a large percentage of Mexico's reserves are borrowed monies, an extremely precarious situation, even by IMF standards.

*** *Mexico will have to begin relying again on speculative capital this year to reduce the deficit.*** Its current account imbalance should increase steadily through 1998 and nearly double the size of last year's deficit. By 2000 it should be approaching 1994 levels. Direct investment would be insufficient to fill this gap even without the current insecurities being felt by emerging-market investors. Furthermore, agreements signed by the Mexican government in the context of NAFTA mean that no controls can be placed on capital flows, making the Mexican economy ever more vulnerable.

*** *Increased poverty and inequality have destabilized Mexican society.*** The OECD recently warned that Mexico's economic crisis and the adjustment measures prescribed by the IMF to address it had increased social contrasts. Intense and pervasive poverty, extreme economic inequities, and a growing desperation and alienation have engendered an increasingly violent response on the part of Mexicans to their current circumstances. Crime in Mexico City and other urban centers has proliferated under the "bailout economy", making it one of the country's major preoccupations. The drug trade continues at ever expanding levels. First in Chiapas and then in other southern states, rebel movements have taken up arms to challenge the government and policies that have kept local populations in poverty. The militarization of this region by the Mexican government has only exacerbated the growing instability.

## Conclusion

The economic policies being imposed upon South Korea, Indonesia and Thailand by the IMF are similar to the structural adjustment policies that brought the Mexican economy to the point of ruin in 1994 and that have continued to be imposed with increased intensity. Policies of austerity, wage suppression and high interest rates and the rapid opening of the economy even before Mexican enterprises and institutions had developed the capacity to compete in the global economy and to manage increased financial flows effectively have been promoted and warmly welcomed by foreign

investors. These measure do not, however, enable Mexico to build the basis of a strong domestic economy and to escape the destructive cycle in which it now finds itself. This IMF production is hardly a model for Asians or anyone else to follow.

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 international 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 -- unless it demonstrates that it is willing and able to fundamentally reform itself -- the less influence, the less money, the less power it has, the better.

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