The Demonstrators

Allan H. Meltzer
Carnegie Mellon University, am05@andrew.cmu.edu

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By Allan H, Meltzer

University Professor of Political Economy,

Carnegie Mellon University and Visiting Scholar,

American Enterprise Institute
The signs that the demonstrators carried in Washington last week indiscriminately condemned all the major international economic institutions—the International Monetary Fund (IMF), the World Bank (Bank), and the World Trade Organization. Like the demonstrators, the institutions are a mixture of good and bad, right and wrong. Their judgments are mainly well-intentioned, but often mistaken. And both demonstrators and the institutions suffer from the major Washington affliction, excessive hubris represented by the firm conviction that they know the best interests of the countries and people that they claim to assist.

Like the demonstrators, the institutions differ greatly both in their mission and in their openness to criticism. The demonstrators do not speak with a single voice. When they speak, they offer a mixture of sense and nonsense. Like many temporary coalitions, they are united by their dislike for what exists, not by a common vision of a better alternative. Some want debt forgiveness. Their
banners and rhetoric should be aimed at the U.S. Treasury which has dragged its feet on total debt forgiveness for impoverished countries that adopt policies that foster growth and higher living standards. Effective policies for growth cannot be sustained without opening to trade, protecting property rights, sustaining the rule of law, and other institutional changes that many members of the coalition strongly oppose.

Most of the demonstrators oppose the Washington consensus—the efforts of the IMF, the Bank and others to require countries to accept long lists of conditions in exchange for financial aid. They are right to do so. Many of the conditions are intrusive and of little value. Much research at the Bank, and elsewhere, shows that foreign aid fosters development only when officials in the country favor reforms and are willing to promote and sustain them. In other cases, the required conditions are often ignored, given lip service but little more. Russia is a case in point, the most familiar
case but, alas, more typical than exceptional. And the financial aid that comes along with the conditions is too often used to sustain anti-growth monetary, tax, and regulatory policies in the recipient countries. Even worse, aid has helped to sustain the Mobutus, Suhartos, Marcoses, and Nigerian generals.

While the demonstrators are right to challenge the Washington consensus and support of rapacious dictators, they neither speak with one voice nor offer valid alternatives. Some talk about letting countries and indigenous peoples choose their own policies, but the overwhelming impression is that the groups organizing the demonstrations are as eager as the IMF or the Bank to impose specific policies on aid recipients. This is certainly true of the AFL-CIO, with its protectionist core labor standards, and the environmental activists. Both offer policies to secure their own interests at the expense of the developing and impoverished
countries. It is not true of many of those in the Jubilee 2000 who ask only for debt forgiveness.

While the media focus is on the streets, the main action for reform has come from Congress. Under the leadership of Dick Armey, Phil Gramm, Jim Saxton, Connie Mack, and others, Congress has taken a more active interest in the international financial institutions. Congress created the Commission that I recently had the honor to chair and asked it to propose changes and reforms that would improve the performance of international financial institutions. And Congress is now beginning to consider legislation that would require the IMF to adopt the Commission's main, bipartisan recommendations.

Secretary Summers followed the Commission report by suggesting four core principles for reform of the IMF that the report endorsed: (1) clear delineation of responsibilities between the IMF, the Bank; (2) a refocused IMF that concentrates on short-term
liquidity lending; (3) establishment of pre-conditions to strengthen local incentives to forestall crises; and (4) dissemination of more, and more timely, information to markets. Leadership at the IMF has accepted some of these core principles. The demonstrators in the street should be watching to see whether the Secretary uses his substantial influence to secure adoption of these principles at the IMF meeting. Adoption would go a long way to improve effectiveness and respond to legitimate complaints about intrusiveness.

Secretary Summers follows the Commission in assigning to the development banks responsibility for targeting financial assistance to the poorest countries that lack access to private sector financing and for increasing production of global public goods that would address problems such as tropical disease, tropical agriculture, forestry, and transnational pollution.
The Commission recommended two types of programs to assist the poorest countries of the world: (1) substitution of subsidized grants for loans to alleviate the worst symptoms of poverty and improve the quality of life, and (2) subsidized loans to support institutional reforms that countries must willingly choose to increase their incomes and living standards permanently. Whatever some demonstrators may claim, open markets, property rights, and individual incentives are the sine qua non of sustained, successful development.

Unlike the IMF, the Bank has chosen to smother proposals for reform in a cascade of words. If the Bank’s management had looked carefully at the Commission’s proposals, they could not fail to notice that many of their comments and criticisms are wrong. Their errors include statements that: (1) the proposals would reduce aid to the poorest countries, (2) lending to middle-income countries provides resources that the Bank uses to pay for programs in the poorest
countries, and (3) markets would not finance improvements in social services and education.

Some of these claims are shocking because they are based on misunderstanding of the Bank's own activities. The Bank does not earn returns on its loans to middle income countries: it lends at its borrowing cost with a premium of ½% to cover administrative costs. There is no profit to be lost by substituting loans for grants. When the Bank lends to countries for social services, education, or other purposes, it receives a guarantee of repayment from the developing country. When private lenders have the same guarantee, they do not care whether the loan finances social reform, education, or any other project with higher social return than its immediate monetary return. Since money is fungible, neither the Bank nor the private lender usually knows precisely what marginal activity the loan supported.

Substituting grants for loans would not reduce the Bank's resources or force its management to ask for support, frequently,
cup in hand, from the U.S. Congress or other developed countries’ parliaments. Adam Lerrick, on the Commission’s staff, has now shown that a properly run grants program would be able to finance, not less but, substantially more assistance to the poorest countries than the Bank currently supports with its loans.

The Bank is an overstuffed, ineffective, bureaucratic institution. Counting its subsidiaries, it has about 12,000 employees, mostly dedicated professionals who are committed to development and poverty relief. Yet the Bank’s record of achievement is far from acceptable. By its own accounting, half its projects are unsuccessful—failures. And the failure rate is higher in the poorest countries, as high as 70%.

The demonstrators in the streets would do better to concentrate their criticisms on the Bank and its management. They should demand that the Bank stop the public relations flim-flam, and undertake a serious effort to improve its effectiveness.