

# The Anti-Market-Agenda of International Organizations



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## Summary

- Several international organizations were originally formed to promote the development of countries, advocating for a liberal policy of free trade, sound national budgets, deregulation and a market economy.
- Today, the former recommendations of the OECD, the IMF and other international organizations are being turned into their opposite. These organizations now advocate more government, higher taxes, less competition and less market-oriented policies.
- International organizations argue that higher government spending leads to better development. But there is no evidence to this claim. Historically, the opposite has always been the case, which can be well observed in the rise of Western nations.
- There are many countries that have expanded their public sectors after becoming wealthy. But these countries would hardly have come to riches in the 1800s and early 1900s if they had had a large tax burden.
- The European Bank for Reconstruction and Development (EBRD) serves as a prime example of the misunderstanding of «development» within international organizations. The EBRD was created to promote market-friendly reforms in the former Eastern Bloc. However, the EBRD, with its practice of subsidized lending to selected companies, is currently preventing an increase in living standards in Eastern countries, distorting markets on the one hand and favoring nepotism and corruption on the other.

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In the 1980s and 1990s, international organizations were perceived to be advocates of the «Washington Consensus», which was an unofficial term for a relatively market-oriented agenda of fiscal probity, deregulation, and open trade. It is difficult to measure the impact of this Consensus or to establish cause and effect, but data from Economic Freedom of the World annual index – which is co-published by the Liberal Institute – demonstrate that there was a significant increase in global economic freedom during those two decades.

In recent years, however, these multilateral organizations have been become more supportive of dirigiste policies. The most infamous example is the anti-tax competition project of the Organization for Economic Cooperation and Development. The OECD was created to promote trade and growth in Western nations, so its campaign to create a de facto tax cartel to support high tax rates and punitive taxation of capital was a remarkable shift from markets to statism.

Unfortunately, that was just the beginning. Other international organizations also have adopted anti-market agendas. One of the most disturbing developments is that these organizations are now explicitly arguing for higher taxes to enable higher burdens of government spending, what allegedly should raise prosperity.

- The European Bank for Reconstruction and Development (EBRD) asserts that «taxing wealth...may be an effective method of fiscal redistribution, as well as a means of raising additional revenue».<sup>1</sup>
- The same EBRD also wrote that «inequality requires...redistribution through taxation and public spending».<sup>2</sup>
- The Organization for Economic Cooperation and Development (OECD) has written that «increased domestic resource mobilization is widely accepted as crucial for countries to successfully meet the challenges of development and achieve higher living standards for their people».<sup>3</sup>
- The OECD also asserted that «now is the time to consider reforms that generate long-term, stable resources for governments to finance development».<sup>4</sup>
- The International Monetary Fund (IMF) is supporting bigger government burdens as well, with news reports quoting the organization's top official stating that «...economies need to strengthen their fiscal frameworks...by boosting...sources of revenues», while also reporting that taxation allows governments to mobilize

<sup>1</sup> Daniel J. Mitchell, «The European Bank for Reconstruction and Development: Cronyism and Corruption Instead of Growth», *Prosperitas* Vol XII, Issue 1, April 2018. Available at <http://freedomandprosperity.org/2018/publications/the-european-bank-for-reconstruction-and-development-cronyism-instead-of-growth/>.

<sup>2</sup> Ibid.

<sup>3</sup> Organization for Economic Cooperation and Development, «Focus on Top Incomes and Taxation in OECD Countries: Was the crisis a game changer?», OECD, 2014. Available at <http://www.oecd.org/els/soc/OECD2014-FocusOnTopIncomes.pdf>.

<sup>4</sup> Organization for Economic Cooperation and Development, «Rising tax revenues: a key to economic development in Latin American countries», OECD, January 25, 2012. Available at <http://www.oecd.org/newsroom/risingtaxrevenue-sakeytoeconomicdevelopmentinlatinamericancountries.htm>.

additional revenues.<sup>5</sup>

- And the United Nations, which has called for a tax on billionaires to help raise more than 400 billion U.S. dollars a year routinely categorizes such tax increases as «financing for development».<sup>6</sup>

## More prosperity due to higher government spending?

As evidenced, the international organizations often have clever euphemisms for tax increases. But «mobilizing revenue», «resource mobilization», and «financing for development» are just different ways of saying that there should be a bigger government financed by higher tax burdens.

There are many problems with this ideological mindset. First, it is anti-historical and anti-empirical. If larger public sectors were the key to growth, proponents of this theory should be asked to explain how the Western world became rich. After all, the burden of government spending was very small back in the 1800s and early 1900s when Western Europe and North America made the transition from agricultural poverty to middle-class prosperity.

The following table based on research by Vito Tanzi (retired, formerly with the IMF) and Ludger Schuknecht (currently Chief Economist at the German Finance Ministry) illustrates that fact.<sup>7</sup> Interestingly, fiscal burdens for Western countries in 1870 and 1913 were significantly smaller than current spending levels in Hong Kong and Singapore, jurisdictions considered to be economically very free by contemporary standards. It is also worth noting that most Western nations did not have income taxes when they made the jump from poverty to prosperity.

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<sup>5</sup> Nicolas Parasie, «IMF Chief Urges Gulf States to Raise Taxes», Wall Street Journal, February 22, 2016. Available at <https://www.wsj.com/articles/imf-chief-urges-gulf-states-to-raise-taxes-1456141250>.

<sup>6</sup> Agence France Presse, «U.N. calls for 'billionaires tax' to help world's poor», *The Daily Star*, July 5, 2012. Available at <http://www.dailystar.com.lb/News/International/2012/Jul-05/179447-un-calls-for-billionaires-tax-to-help-worlds-poor.ashx>.

<sup>7</sup> Vito Tanzi and Ludger Schuknecht, *Public Spending in the 20<sup>th</sup> Century: A Global Perspective*, Cambridge University Press, 2000. Available at <https://assets.cambridge.org/052166/2915/sample/0521662915wsn01.pdf>

*Table 1: Government spending growth, 1870-1913 (as a percentage of national GDP)*

	<b>Late 19th Century around 1870</b>	<b>1913</b>
Australia	18.3	16.5
Austria	10.5	17.0
Belgium	...	13.8
Germany	10.0	14.8
Great Britain	9.4	12.7
France	12.6	17.0
Italy	13.7	17.1
Japan	8.8	8.3
Netherlands	9.1	9.0
Norway	5.9	9.3
Spain	...	11.0
Sweden	5.7	10.4
Switzerland	16.5	14.0
USA	7.3	7.5
<b>Average</b>	<b>10.7</b>	<b>12.7</b>

To supplement these numbers, let us now look at the research on fiscal burdens from 1880 until today (see illustration 1).<sup>8</sup> Once again, we see that the government spending consumed only about 10 percent of economic output in Western nations in the period before World War I.

Reviewing these numbers, we return to the fundamental question of why international organizations claim higher fiscal burdens are necessary for growth when the data show that government spending was very modest in the period when Western nations enjoyed the big jump out of poverty.

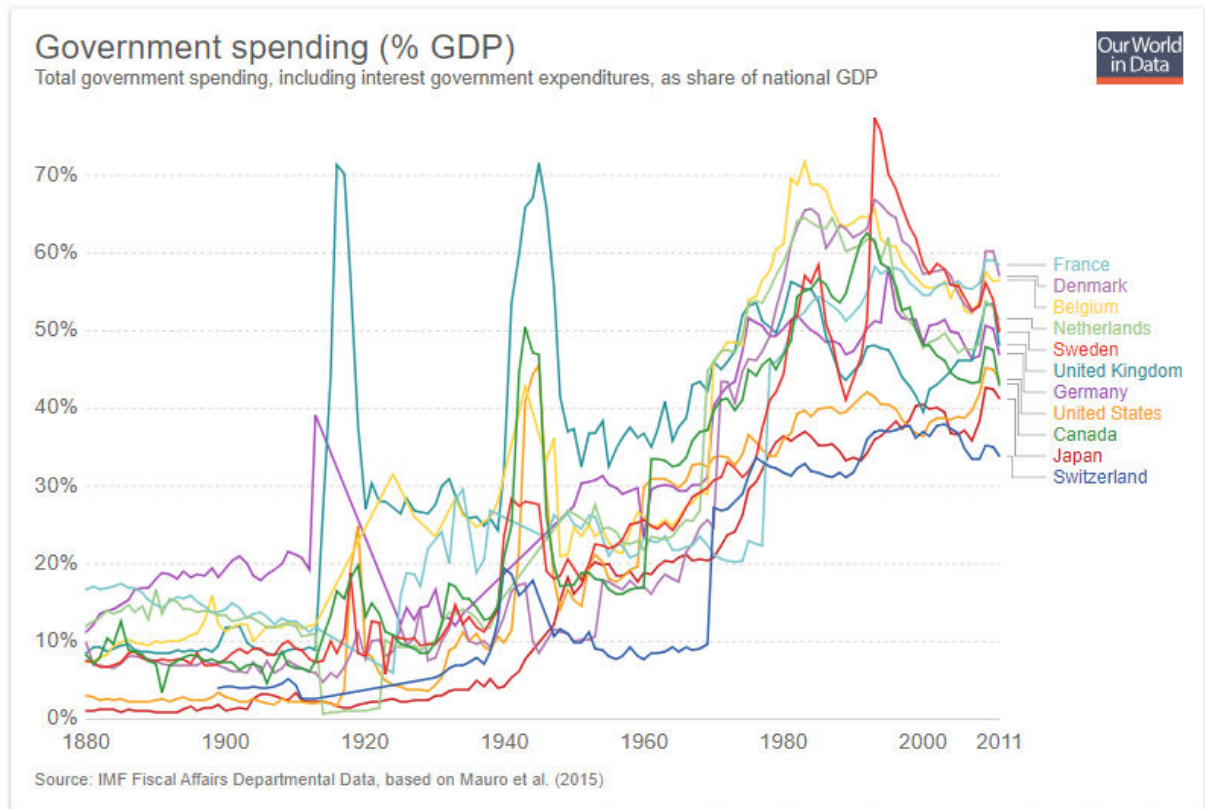
Indeed, perhaps the question should be turned into a challenge. Can the international organizations provide evidence of a single nation that became rich with a big government?

Yes, there are plenty of nations that adopted large public sectors after they became rich, including all the countries in the chart below. This phenomenon is known in the academic literature as Wagner's Law.<sup>9</sup> But would those nations have become rich in the 1800s and early 1900s if they had bigger burdens of government spending, along with concomitantly punitive tax regimes? Since there are no examples of poor countries adopting big government and then becoming rich, the answer surely is no.

<sup>8</sup> Esteban Ortiz-Ospina and Max Roser (2017) - «Public Spending». Published online at OurWorldInData.org. Retrieved from: '<https://ourworldindata.org/public-spending>' [Online Resource]

<sup>9</sup> Wikipedia, Wagner's Law, accessed May 28, 2018 at [https://en.wikipedia.org/wiki/Wagner%27s\\_law](https://en.wikipedia.org/wiki/Wagner%27s_law).

Illustration 1: Growth of government expenditure, 1880-2011 (as a percentage of national GDP)



## Expanding the welfare state lowers living standards

Let us close this section by examining historical data on social-welfare outlays. There is a theoretical argument for why capital expenditures such as infrastructure might boost an economy's performance. But the international organizations cited above primarily are urging higher taxes and bigger government to fund expansions of the welfare state. So let us look at Vito Tanzi's data on the level of social transfers during the 1800s and early 1900s when Western nations became prosperous.<sup>10</sup> As can be seen, the contemporary welfare state did not exist.

<sup>10</sup> V. Tanzi, I. Stelzer, P. B. Sørensen, D. Snower, D. Lal, A. Brown, A. L. Bovenberg and S. Lawlor, *Poverty or Prosperity: What Tax is Best for a Flourishing Economy?*, Politeia, April 2010. Available at <http://www.politeia.co.uk/poverty-or-prosperity-what-tax-is-best-for-a-flourishing-economy-by-v-tanzi-i-stelzer-p-b-sorenson-d-snower-d-lal-a-brown-a-l-bovenberg-and-s-lawlor/>.

*Table 2: Social transfers as a percentage of national GDP at current prices in selected OECD countries, 1880-1995*

	1880 <sup>a</sup>	1890 <sup>a</sup>	1900 <sup>a</sup>	1910 <sup>a</sup>	1920 <sup>a</sup>	1930 <sup>a</sup>	1960 <sup>b</sup>	1970 <sup>b</sup>	1980 <sup>b</sup>	1980 <sup>c</sup>	1995 <sup>c</sup>
Australia	0	0	0	1.12	1.66	2.11	7.39	7.37	12.79	10.90	14.84
Austria	0	0	0	0	0	1.20	15.88	18.90	23.27	23.43	21.39
Belgium	0.17	0.22	0.26	0.43	0.52	0.56	13.14	19.26	30.38	22.45	27.13
Canada	0	0	0	0	0.06	0.31	9.12	11.80	14.96	12.90	18.09
Denmark	0.96	1.11	1.41	1.75	2.71	3.11	12.26	19.13	27.45	26.44	30.86
Finland	0.66	0.76	0.78	0.90	0.85	2.97	8.81	13.56	19.19	18.32	31.65
France	0.46	0.54	0.57	0.81	0.64	1.05	13.42	16.68	22.55	22.95	26.93
Germany	0.50	0.53	0.59	0	0	4.82	18.10	19.53	25.66	20.42	24.92
Great Britain	0.86	0.83	1.0	1.38	1.39	2.24	10.21	13.20	16.42	11.43	13.67
Greek	0	0	0	0	0	0.07	10.44	9.03	11.06	8.67	14.43
Ireland						3.74	8.70	11.89	19.19	16.20	18.30
Italy	0	0	0	0	0	0.08	13.10	16.94	21.24	17.10	23.71
Japan	0.05	0.11	0.17	0.18	0.18	0.21	4.05	5.72	11.94	10.48	12.24
Netherlands	0.29	0.30	0.39	0.39	0.99	1.03	11.70	22.45	28.34	26.94	25.70
New Zealand	0.17	0.39	1.09	1.35	1.84	2.43	10.37	9.22	15.22	16.22	18.64
Norway	1.07	0.95	1.24	1.18	1.09	2.39	7.85	16.13	20.99	18.50	27.50
Sweden	0.72	0.85	0.85	1.03	1.14	2.59	10.83	16.76	25.94	12.97	19.01
Switzerland	...	...	...	...	...	1.17	4.92	8.49	14.33	...	18.87
USA	0.29	0.45	0.55	0.56	0.70	0.56	7.26	10.38	15.03	21.36	22.52

Source: Lindert (2002); OECD (1985)

0 = Known to be zero.

Blank = not yet a sovereign state.

... = known to be positive, but number is not available.

<sup>a</sup> Welfare, unemployment, pensions, health, and housing subsidies.

<sup>b</sup> OECD old series.

<sup>c</sup> OECD new series.

The problems with international organizations are not limited to fiscal policy. Equally problematic is the way certain multilateral organizations encourage moral hazard by supporting bailouts. And there are many other examples of these organizations supporting statist dirigiste policy. The European Bank for Reconstruction and Development is an example of this unfortunate tendency.

## The European Bank for Reconstruction and Development

The European Bank for Reconstruction and Development is a prime example for those tendencies. The EBRD was created to promote market-friendly reforms in the former Soviet Bloc. That was a very worthwhile goal, although it remains unclear how an international bureaucracy was supposed to produce national economic reforms.

In any event, the operational model of the EBRD undermines pro-growth reform since it is based on cronyism. More specifically, it explicitly exists to channel subsidized credit to targeted businesses. And this approach produces three counterproductive consequences.

## 1. Capital Misallocation

A «macro» problem that is common to all multilateral development banks, as well as other international financial institutions such as the International Monetary Fund, is that the decisions of these organizations distort the allocation of capital.

In a normal economy, savers, investors, intermediaries, entrepreneurs, and others make decisions on what projects get funded and what businesses attract investment. These private-sector participants have «skin in the game» and relentlessly seek to balance risk and reward. Wise decisions are rewarded by profit, which often is a signal for additional investment to help satisfy consumer desires.

There's also an incentive to quickly disengage from failing projects and investments that don't produce goods and services valued by consumers. Profit and loss are an effective feedback mechanism to ensure that resources are constantly being reshuffled in ways that produce the most prosperity for people.

The EBRD interferes with that process. Every euro it allocates necessarily diverts capital from more optimal uses. Defenders of the status quo argue that the EBRD fulfills an important role by supplying capital to underserved regions. But this is wrong on two levels.

1. Good investments would not need subsidized capital, particularly in a world awash in capital seeking profitable opportunities.
2. If investments in a certain region are not attractive, that means one of two things:
  - a. it would be a waste of money to divert capital to that region;
  - b. there are policy barriers to capital that local governments should fix.

## 2. Cronyism

A «micro» problem is that the EBRD is in the business of «picking winners and losers». This means that intervention by the bureaucracy necessarily distorts competitive markets. Any firm that gets money from the EBRD is going to have a significant advantage over rival companies. Preferential financing for hand-picked firms from the EBRD also is a way of deterring new companies from getting started since there is not a level playing field or honest competition.

As the *Economist* observed, «...for the past 20 years, from Malaysia to Mexico, crony capitalists—individuals who earn their riches thanks to their chumminess with government—have had a golden era», and «industries that have a lot of interaction with the state are vulnerable to crony capitalism».<sup>11</sup>

<sup>11</sup> *Economist*, «Comparing crony capitalism around the world», May 5, 2016. Available at <https://www.economist.com/blogs/graphicdetail/2016/05/daily-chart-2>.

Matt Ridley, writing for the U.K.-based *Times*, warned that «continuing prosperity depends on...what the economist Joseph Schumpeter called creative destruction. ...There is ever more opportunity to live off «rents» from artificial scarcity created by government... Businesses become embedded in government cronyism...heavily dependent on government contracts, favours or subsidies».<sup>12</sup>

In other words, cronyism is a threat to prosperity. It means the playing field is unlevel and that those with political connections have an unfair advantage over those who compete fairly.

To top it off, countries receiving funds from the EBRD are already getting grim scores on the Economic Freedom of the World index for the two sub-categories («government enterprises and investment» and «business regulations»), which are probably the best readings for nepotism. The donor countries from Western Europe and the United States differ considerably from the recipient countries of the former Eastern Bloc. Both in the category «government enterprises and investment» (donor countries: 8.72, recipient countries: 6.54 out of 10) and «business regulations» (donor countries: 7.77, recipient countries: 6.62 out of 10), the recipient countries of the former Eastern Bloc still have considerable catching up to do.<sup>13</sup>

Given that recipient nations already have a severe problem with cronyism, it is remarkable that the EBRD is enabling and encouraging these bad policies. Especially when the donor nations – while far from perfect – have done a decent job of insulating their economies from cronyist policies.

Some might argue that the EBRD's track record of not losing money insulates it from the charge of cronyism. Yet after-the-fact profitability is not a measure of success since subsidized capital can allow a firm to gain an undeserved advantage over competitors. In other words, it is a sign of successful cronyism rather than successful governance.

### 3. Corruption

When governments have power to arbitrarily disburse large sums of money, that is a recipe for unsavory behavior. For all intents and purposes, the practice of cronyism is a prerequisite for corruption. The EBRD openly brags about the money it steers to private hands, so is it any surprise that people will engage in dodgy behavior in order to turn those public funds into private loot?

For instance, a column in the *EU Observer* noted that «EBRD money has ended up in the pockets of people associated closely with the authoritarian regime of President Alexander Lukashenko in Belarus, raising some doubts over the verification mechanisms

<sup>12</sup> Matt Ridley, «Cautious crony organizations stifle innovation,» *Times*, April 9, 2018. Available at <https://www.thetimes.co.uk/edition/comment/cautious-crony-organisations-stifle-innovation-0bswjhk8p>.

<sup>13</sup> James Gwartney, Robert Lawson, and others, *Economic Freedom of the World*, Fraser Institute, September 28, 2017. Available at <https://www.fraserinstitute.org/studies/economic-freedom-of-the-world-2017-annual-report>.



in place at the bank to ensure the public money it disburses actually benefits ordinary people in its theatre of operations».<sup>14</sup>

Another analysis found that «in the EBRD's projects, an increasing number of cases are becoming visible in which serious allegations of corruption do not seem to have had an impact on the EBRD's stance towards the project or the company leading the projects».<sup>15</sup>

None of this should be a surprise. Recipient nations get comparatively poor scores for «legal system and property rights» from Economic Freedom of the World. They also do relatively poorly when looking at the World Bank's governance indicators.<sup>16</sup> And they also have disappointing numbers from Transparency International's corruption perceptions index.<sup>17</sup>

It is therefore no surprise that monies ostensibly disbursed for the purpose of development assistance wind up lining the pockets of corrupt insiders. For all intents and purposes, the EBRD and other dispensers of aid enable and sustain patterns of corruption.

Ironically, even the EBRD's own research indicates that government facilitates and enables corruption. A working paper from 2015 found that «...unexpected financial windfalls increase corruption in local government. ...Our results imply that a 10 per cent increase in the per capita amount of disbursed funds leads to a 12.2 per cent increase in corruption. ...Our results highlight the governance pitfalls of...assistance from international organizations».<sup>18</sup>

## Conclusion

To make the world a better place, particularly for the less fortunate, it is vitally important to promote economic development and higher living standards. But international organizations are not helping to achieve those goals. Indeed, such organizations are undermining global prosperity by pursuing a dirigiste agenda of bigger public sectors and more intervention.

It's unclear why donor nations such as Switzerland and the United States should continue to support these organizations.

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<sup>14</sup> Ionut Apostol, «Lessons Learned for the EBRD», EU Observer, April 10, 2012. Available at <https://eu-observer.com/opinion/115831>.

<sup>15</sup> CEE Bankwatch Network «Coal and corruption – the case of the European Bank for Reconstruction and Development,» December 2013. Available at <https://bankwatch.org/wp-content/uploads/2013/12/EBRD-coal-corruption.pdf>.

<sup>16</sup> World Bank, Worldwide Governance Indicators, (accessed May 28, 2018). Available at <http://data-bank.worldbank.org/data/reports.aspx?source=worldwide-governance-indicators>.

<sup>17</sup> Transparency International, Corruption Perceptions Index, 2017, February 21, 2018. Available at [https://www.transparency.org/news/feature/corruption\\_perceptions\\_index\\_2017](https://www.transparency.org/news/feature/corruption_perceptions_index_2017).

<sup>18</sup> Elena Nikolova and Nikolay Marinov, «Do public fund windfalls increase corruption? Evidence from a natural disaster,» Working Paper No. 179, European Bank for Reconstruction and Development, April 2015. Available at <http://www.ebrd.com/documents/oce/do-public-fund-windfalls-increase-corruption-evidence-from-a-natural-disaster.pdf>.



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