

CRS Report for Congress

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The Asian (Global?) Financial Crisis, the IMF, and Japan: Economic Issues

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ABSTRACT

This report focuses on several economic aspects of the Asian (global?) financial crisis, the International Monetary Fund (IMF), and Japan. It briefly examines the origins, effects, and policy options with respect to the Asian financial crisis, provides information on the size of and actual disbursements under the IMF support packages to Thailand, Indonesia, and South Korea, and discusses issues related to the IMF such as IMF resources, moral hazard, contagion, conditionality, prevention, and transparency. It also examines effects on the U.S. economy in terms of economic growth, the trade deficit, U.S. exports to Asia, and on specific sectors of the economy. Finally, it discusses Japan's economic weakness and how that weakness relates to the Asian financial crisis. This report will be updated periodically as economic conditions change. Other CRS products on this topic include CRS Report 97-1021, *The 1997-98 Asian Financial Crisis*, CRS Report 98-238, *The Asian Financial Crisis: Chronology, Press Releases, Exchange Rates, and Stock Market Indices*, and CRS Report 98-74, *Asian Financial Crisis: An Analysis of U.S. Foreign Policy Interests and Options*. Information and legislation on funding for the International Monetary Fund can be found in CRS Report 98-56, *The International Monetary Fund's (IMF) Proposed Quota Increase: Issues for Congress*, CRS Issue Brief 97038, *The International Monetary Fund's "New Arrangements to Borrow" (NAB)*, and CRS Report 98-123, *Supplemental Appropriations and Rescissions for FY1998*.

The Asian (Global?) Financial Crisis, the IMF, and Japan: Economic Issues

Summary

The Asian financial crisis involves four basic problems or issues: (1) the role, operations, and replenishment of funds of the International Monetary Fund, (2) a shortage of foreign exchange in Thailand, Indonesia, South Korea and other Asian countries that has caused the value of currencies and equities to fall dramatically, (3) inadequately developed financial sectors and mechanisms for allocating capital in the troubled Asian economies, and (4) effects of the crisis on both the United States and the world. In 1998, the crisis that had been confined primarily to Asia appeared to be spreading to the world. The crisis was taking global dimensions.

The Asian financial crisis was initiated by two rounds of currency depreciation that have been occurring since early summer 1997. The first round was a precipitous drop in the value of the Thai baht, Malaysian ringgit, Philippine peso, and Indonesian rupiah. As these currencies stabilized temporarily, the second round began with downward pressures hitting the Taiwan dollar, South Korean won, Brazilian real, Singaporean dollar, and Hong Kong dollar. Governments have countered the weakness in their currencies by selling foreign exchange reserves and raising interest rates, which, in turn, have slowed economic growth and have made interest-bearing securities more attractive than equities. The currency crises also has revealed severe problems in the banking and financial sectors of the troubled Asian economies.

The International Monetary Fund has arranged support packages for Thailand (\$17.2 billion), Indonesia (\$42.3 billion), and South Korea (\$58.2 billion). The packages include an initial infusion of funds with conditions that must be met for additional loans to be made available. The actual funds disbursed to date include only those from the IMF, World Bank, and Asian Development Bank. The United States has offered a line of credit from its Exchange Stabilization Fund for Indonesia and South Korea. Under separate initiatives, the U.S. Export-Import Bank and U.S. Department of Agriculture have allocated trade credits and loan guarantees to finance U.S. exports to the troubled Asian countries.

The U.S. Congress is considering the Asian financial crisis within three broad legislative contexts. The first is in the financing and scope of the activities of the IMF. This includes legislation to provide the IMF with a \$17.9 billion increase in its quotas or capital subscriptions and New Arrangements to Borrow. Questions are being asked, however, about the need for the additional funding, whether the IMF creates a moral hazard, and whether the IMF should attach different conditions to its support packages. The second legislative context is in the impact of the crisis on the U.S. economy and American financial institutions. Forecasters foresee a decline in U.S. economic growth of about 0.5 percentage point and an increase in the U.S. trade deficit of about \$65 billion because of the crisis. The third context is the efforts of other countries, particularly Japan, in resolving the problem. Although Japan has pledged credits under the IMF support packages, its economy is in recession and it has not been performing its role as an engine of growth and absorber of exports from its neighbors in Asia. Rather, Japan's trade surplus is rising, particularly with the United States.

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The Asian (Global?) Financial Crisis, the IMF, and Japan: Economic Issues

Introduction

The Asian financial crisis involves five basic problems or issues: (1) the role, operations, and replenishment of funds of the International Monetary Fund (IMF), (2) a shortage of foreign exchange in Thailand, Indonesia, South Korea and other countries that has caused the value of currencies and equities to fall dramatically, (3) inadequately developed financial sectors and mechanisms for allocating capital in the troubled Asian economies, (4) Japan's role in the financial crisis, and contagion effects of the crisis on the United States and other countries of the world, particularly Russia and Latin America. The Asian financial crisis may be spreading to the rest of the world.

The focus of this report is on the economic issues related to the Asian financial crisis. Russia also is undergoing a similar crisis and has received support from the IMF. The Russian problem is addressed separately in CRS report 98-578. This report provides a short description of the crisis in Asia, a summary of the IMF support packages for Thailand, Indonesia, and South Korea, a discussion of the role of the IMF and some of the legislative issues involved, the effects on the U.S. economy, and a discussion of Japan's role in the crisis. This report will be updated periodically. A more detailed discussion of the origins of the crisis, the IMF support packages, and implications for U.S. foreign policy can be found in CRS Reports 97-1021, *The 1997-98 Asian Financial Crisis*; 98-238, *The Asian Financial Crisis: Chronology, Press Releases, Exchange Rates, and Stock Market Indices*, and 98-74, *Asian Financial Crisis: An Analysis of U.S. Foreign Policy Interests and Options*. Information on the International Monetary Fund and legislation can be found in CRS Report 98-56, *The International Monetary Fund's (IMF) Proposed Quota Increase: Issues for Congress*, and CRS Issue Brief 97038, *The International Monetary Fund's "New Arrangements to Borrow" (NAB)*.

Legislative Context

The U.S. Congress is considering the Asian financial crisis within three broad legislative contexts. The first is in the financing and scope of the activities of the IMF and other international financial institutions. Attempts to resolve the problems have been led by the International Monetary Fund (IMF) with cooperation from the World Bank, Asian Development Bank, and several nations. In the 105th Congress, legislation is being considered to provide an additional \$17.9 billion in capital and a credit line for the IMF. This includes \$3.5 billion in New Arrangements to Borrow and a \$14.4 billion increase in the U.S. subscription to the IMF quotas or capital base. The legislation includes new conditions for the IMF to impose on borrowers, requires

greater transparency by the IMF, new reporting requirements, and other provisions that deal with IMF operations.

The second legislative context occurs in the impact of the Asian financial crisis on the U.S. economy. Financial markets are interlinked. What happens in Asian financial markets often affects U.S. markets — both financial and real. Not only has the value of Asian equities on their stock markets affected U.S. investors, but the financial problems in Asia are expected to increase the U.S. trade deficit by about \$65 billion in 1998, reduce U.S. economic growth by about 0.5 percentage point, and affect values on U.S. equity markets.

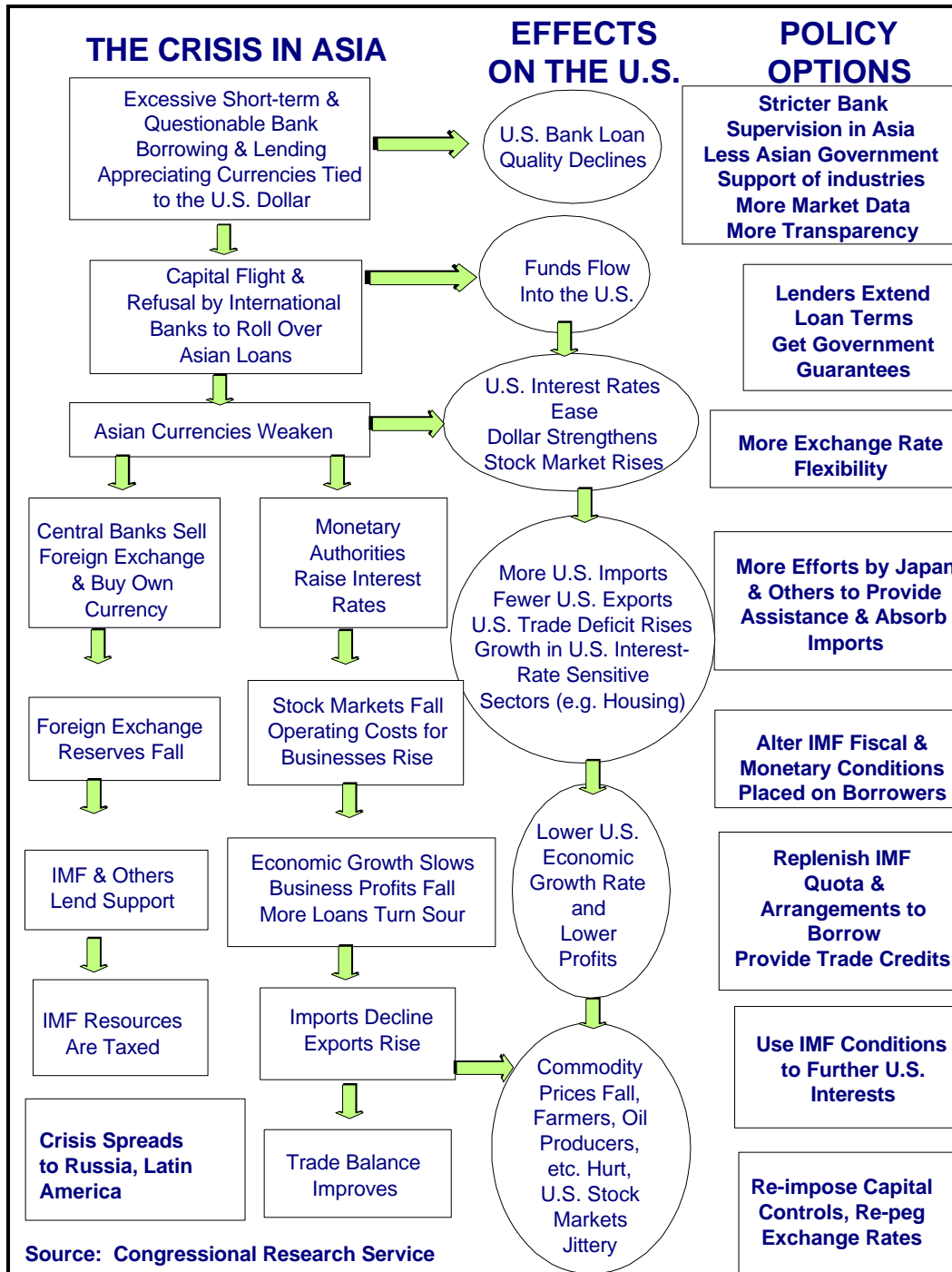
The third legislative context is in actions other nations, particularly Japan and the Asian nations with currency problems, are taking to cope with the crisis. For Japan, the question is whether its fiscal policies, restructuring, and measures to resolve its problem with nonperforming bank loans are sufficient to bring its economy out of recession, absorb more of the exports from the troubled Asian economies, and strengthen the value of the yen. As for Thailand, Indonesia, and South Korea — the three countries that have received IMF assistance — Indonesia is facing the most difficulty with its currency down about 70% and economic and political conditions unstable. Although the IMF and Indonesia came to a new understanding on economic and financial policies and Indonesia's President has changed, important questions remain to be addressed before economic conditions in this fourth most populous country in the world return to normal. Thailand and South Korea are undergoing major structural changes and recovery is not expected to begin until after 1999.

An Outline of the Crisis

An outline of the Asian Financial Crisis, its major effects on the United States, and some policy issues are presented in **Figure 1**. In essence, beginning in the summer of 1997, a combination of excessive short-term and questionable bank borrowing in the troubled Asian countries, lax oversight and regulation of financial institutions, overheated property markets, and a structural relationship in which their currencies were tied to an appreciating dollar (which led to rising trade deficits) generated doubts among investors and lenders that Thailand and other Asian governments could maintain their pegged exchange rates. This induced capital flight, speculation that currency depreciation would occur, and a growing reluctance by international lenders to roll over short-term loans. As speculators attacked exchange rates and central banks depleted their foreign exchange reserves attempting to defend them, currencies weakened further. Monetary authorities responded by raising interest rates to try to keep capital from leaving their respective countries. This caused values on equity markets to decline and even more investors to flee local stock markets. Within a half year, about \$700 billion was lost in Asian equity markets, and many once-pegged exchange rates dropped considerably.

The falling currency values and rising interest rates hit local Asian businesses hard. Not only were the size of their international loan repayments growing with each drop in their exchange rates, but supplies of trade credit and loans to fund daily

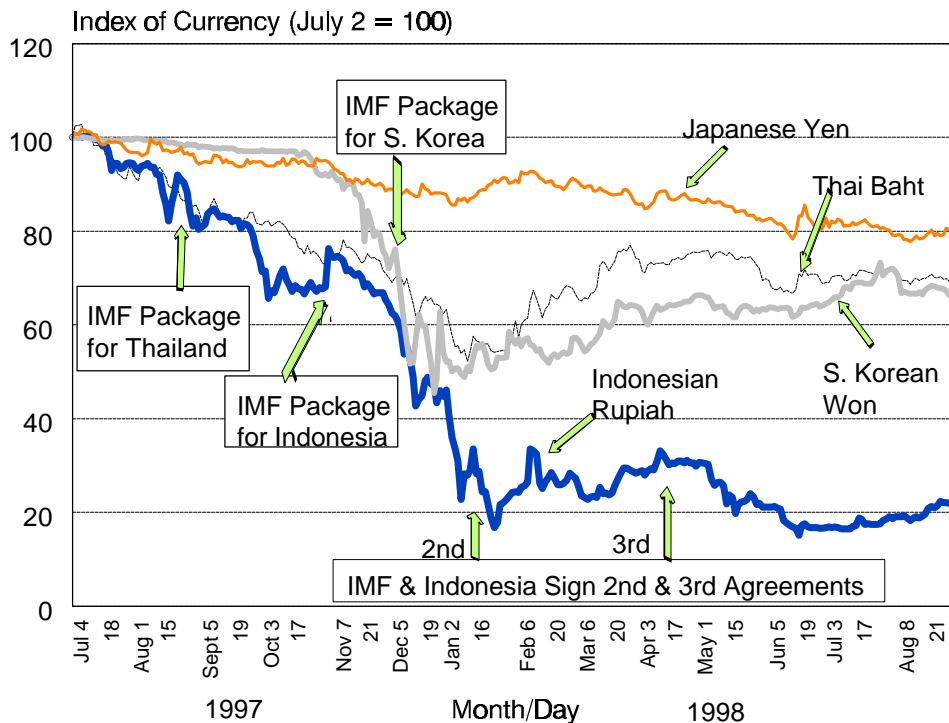
Figure 1. Policy Options and Outline of the 1997-98 Asian Financial Crisis as It Occurred in Thailand, Indonesia, and South Korea and Affected the United States



operations shrunk considerably. Asian businesses began facing default — not only on their international loans — but on domestic ones also. Despite the fact that certain Asian exports had become significantly more price competitive in foreign markets (because of the depreciation in exchange rates), Asian exporters faced difficulty acquiring the finance capital to manufacture the goods for export. For the economies as a whole, economic growth was slowing, business profits falling, and more and

more loans were turning sour. First Thailand, then Indonesia and South Korea were compelled to turn to the International Monetary Fund for emergency financial assistance. The Philippines had an existing credit line in place, and Malaysia took resolute action to avoid having to resort to IMF support. The IMF coordinated support packages to the three nations that included initial infusions of loans to ease the liquidity crises and lines of credit that could be activated later. In return, the IMF placed conditions of the countries for specific reforms that were designed to keep the problems from recurring.

Figure 2. Exchange Values of the Japanese Yen, Thai Baht, Indonesian Rupiah, and South Korean Won Relative to the U.S. Dollar
July 1997-August 1998



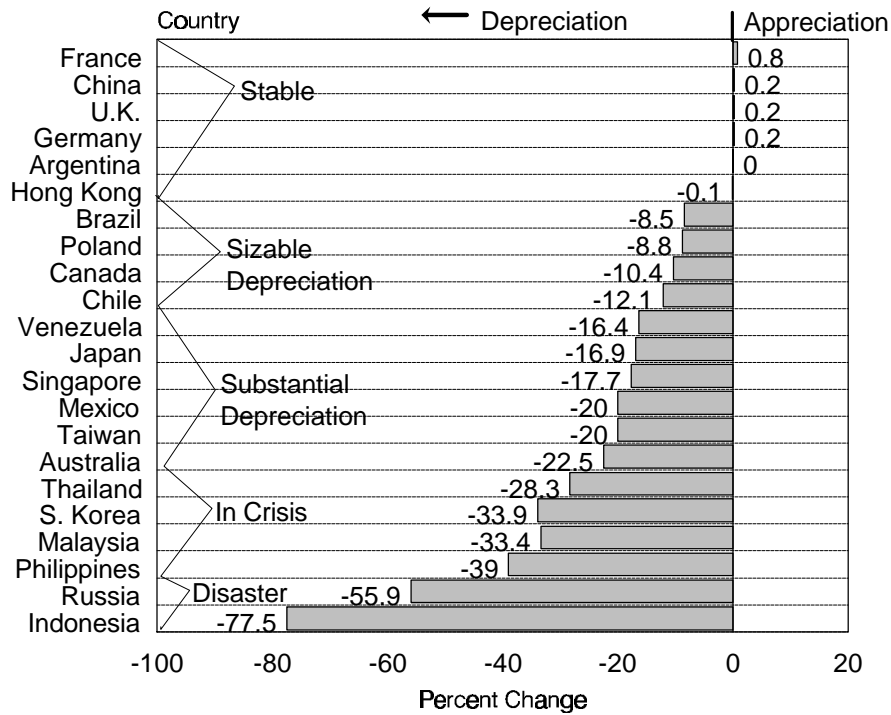
Source: PACIFIC Exchange Rate Service

Figure 2 shows the value of the Japanese yen, Thai baht, Indonesian rupiah, and South Korean won relative to the U.S. dollar. The currency depreciation that began in Thailand soon became contagious and affected other currencies as well. Some (such as the Hong Kong dollar and Chinese renminbi) proved quite resilient to this “Asian flu,” but others likewise fell. Each has stabilized recently — albeit at considerably lower levels relative to their exchange values at the beginning of July 1997. The exchange value of the Japanese yen, which was not an issue at the beginning of the crisis, has continued to erode. If its value declines much more, it could trigger further declines in other Asian currencies — perhaps even the Chinese renminbi and Hong Kong dollar .

Figure 3 shows the total percentage change (appreciation or depreciation) in the value of selected currencies relative to the U.S. dollar from July 1, 1997 to September 2, 1998. These currencies can be grouped into those with stable currencies (France,

China, the United Kingdom, Germany, Argentina, and Hong Kong), those with a sizable depreciation of about 10% (Brazil, Poland, Canada, and Chile), those experiencing substantial currency depreciation with declines of 15 to 25% (Venezuela, Japan, Singapore, Mexico, Taiwan, and Australia), those countries in crisis with depreciation of 25 to 50% (Thailand, South Korea, Malaysia, and the Philippines), and those with a financial disaster on their hands with depreciation of more than 50% (Russia and Indonesia). The exchange values of the currencies of the three Asian nations that have received IMF assistance have fallen as follows: Thailand 28.3%, South Korea 33.9%, and Indonesia 77.5%. As of early September 1998, the Russian ruble was yet to stabilize. The currency crisis had reignited and had spread to Russia and was threatening Latin America.

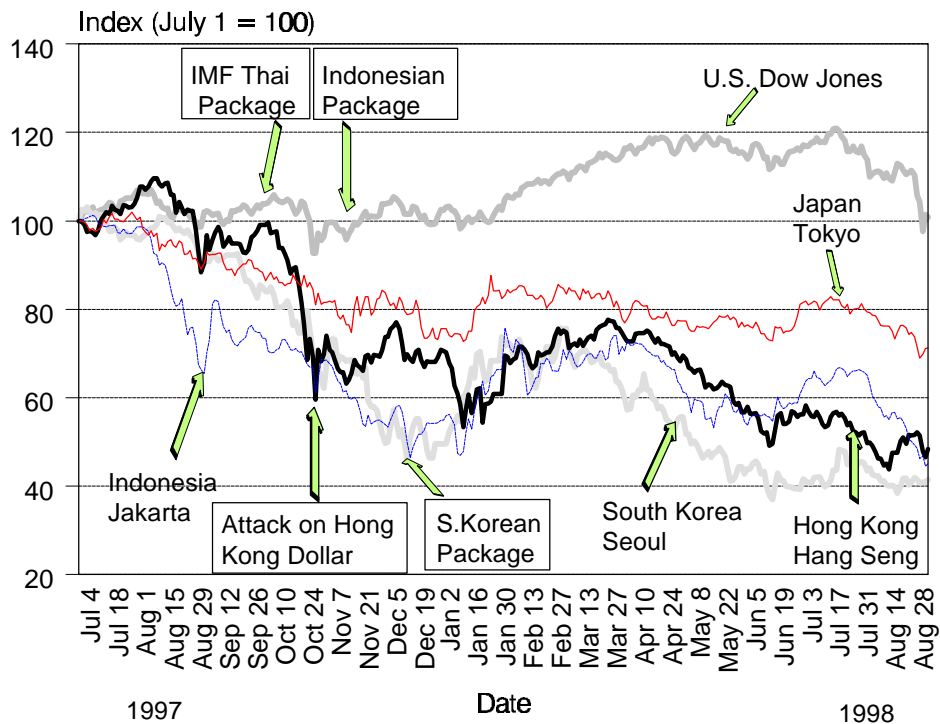
Figure 3. Total Changes in the Exchange Value of Selected Currencies Relative to the Dollar, July 2, 1997 to September 2, 1998



Data Source: PACIFIC Exchange Rate Service

As currency values have fallen, monetary authorities have attempted to defend their exchange rates by raising interest rates and taking other austerity measures. These higher interest rates in combination with lower economic growth and the threat of further currency depreciation have caused investors to withdraw funds from the troubled countries and invest them in less risky markets, such as those in the United States. This has caused stock values on the Asian markets to fall. As capital flowed into the United States, moreover, values on U.S. markets have risen, and U.S. interest rates have fallen.

Figure 4. Stock Market Indexes for the United States, Japan, Thailand, South Korea, and Indonesia, July 1, 1997 to August 20, 1998



Source: Trendlines, *Financial Times*. Seoul Composite, Jakarta Composite, Tokyo Nikkei 225, Hong Kong Hang Seng, & Dow Jones Industrial Indices

Figure 4 shows indexes of stock values denominated in local currencies for the United States, Japan, Hong Kong, South Korea, and Indonesia. The linkages that had developed among world equity markets was demonstrated dramatically in late October 1997 when the Hong Kong monetary authority had to defend its fixed exchange rate. The resultant high interest rates caused values on the Hong Kong stock exchange to fall which triggered a similar decline in values in South Korea and even in the United States. Turmoil continued through 1997, but in early 1998, markets had stabilized and appeared to be recovering. The U.S. Dow Jones average climbed to record highs. As spring turned to summer, however, a rising U.S. trade deficit in combination with lower corporate profits and a more pessimistic outlook for Asian economies began to be reflected in stock prices. During July and August, all five of the indexes have declined. The Russia Trading Index of stock values (not shown) had fallen even more dramatically. At the end of August 1998, it was 84% below its level in July 1997.

One structural change that is causing world stock markets to become more interlinked has been the rise of mutual funds. When mutual fund managers incur losses in one market (Hong Kong, for example), they may sell stock on another market (New York?) in order to realize profits there and make up for the losses. The popularization of no-load mutual funds (no entry fees) in combination with Internet trading also implies that investors can move in and out of funds more quickly and inexpensively. Investor withdrawals because of a stock decline in one market, therefore, can start a chain reaction as fund managers are forced to liquidate stocks in other markets in order to meet the cash requirements of investors leaving the funds.

IMF Support Packages

As the Asian financial crisis hit Thailand, Indonesia, and South Korea, each approached the International Monetary Fund, World Bank, Asian Development Bank and certain countries for help. The IMF coordinated the response with support packages that were designed to restore investor confidence — both international and local — in the economies of the recipient nations. The packages constituted a three-pronged approach to the problems: (1) **immediate efforts** to restore liquidity in currency markets by providing loans, introducing more flexibility to exchange rates, a tightening of monetary policy (raising interest rates), efforts to reopen lines of external financing, and maintenance of sound fiscal policies; (2) **structural reforms** aimed at strengthening financial sectors which included closing unviable financial institutions, recapitalizing some institutions, improving supervision and regulation, and allowing for more foreign participation in domestic financial systems; and (3) addressing **governance issues** underlying the crisis which included improving the efficiency of markets, breaking the “crony capitalism” links between business and government, liberalizing capital markets, and providing for more transparency (in disclosing data on external reserves and liabilities).¹ The financial commitments are summarized in **Table 1**.

Table 1. IMF Financial Support Packages
(Amounts in U.S.\$Billion)

	Thailand	Indonesia	South Korea
Date Initially Approved (1997)	August 20	November 5	December 4
Total Pledged	\$17.2	\$42.3	\$58.2
First-Line Lending			
IMF	\$4.0	\$11.2	\$20.9
World Bank, Asian Development Bank	\$2.7	10.0	\$14.0
Secondary Lines of Credit			
U.S.	None	\$3.0	\$5.0
Japan	\$4.0	\$5.0	\$10.0
Others	\$6.5	\$13.1	\$10.3

Source: World Bank, Asian Development Bank Press and News Releases, *Wall Street Journal*. International Monetary Fund. The IMF's Response to the Asian Crisis. April 1998. On Internet at <<http://www.imf.org/External/np/exr/facts/asia.htm>>.

¹International Monetary Fund. The IMF's Response to the Asian Crisis. July 27, 1998. On Internet at <<http://www.imf.org/External/np/exr/facts/asia.HTM>>.

The total amounts of the packages are approximate because the IMF lends funds denominated in special drawing rights (SDRs), and because pledged amounts have changed as circumstances have changed. The support package for Thailand was \$17.2 billion. For Indonesia the total package reached \$42.3 billion, and the package for South Korea was even higher at \$58.2 billion.²

The program begins with loans from the IMF, World Bank, and Asian Development Bank — the first-line lenders. The rest of the support package consists of secondary lending that is to be activated only under emergency conditions. As part of these secondary lines of credit, the United States pledged \$3 billion for Indonesia and \$5 billion for South Korea from its Exchange Stabilization Fund (ESF). No funds have yet been disbursed for the two Asian nations from the ESF. The U.S. Treasury lends money from the ESF at appropriate interest rates and with what it considers to be proper safeguards to limit the risk to American taxpayers. This fund of approximately \$30 billion has been self-financing after the initial appropriation of \$2 billion in 1934 and has been used to provide loans to many Latin American, Asian, African, and European countries experiencing currency difficulties. This includes \$12 billion loaned to Mexico in 1995 at the time of the Peso crisis. Loans from the ESF do not require congressional approval. (In the 105th Congress, several bills have been introduced that would impose restrictions on the amount of ESF loans under certain conditions, require money to be transferred from the ESF to another fund, or require reports by the Administration on the ESF.)³

After the IMF commits funds to a support package, it begins with an initial loan installment (tranche) of hard currency to the borrowing nation. The loan is conditioned upon certain actions or commitments by the borrowing country. Subsequent amounts are made available (usually quarterly) only if certain performance criteria are met and satisfactory program reviews are completed. The funds borrowed by the recipient country usually go into the central bank's foreign exchange reserves. These reserves are used to supply foreign exchange to sellers of the domestic currency — both domestic and international. Since the funds from the IMF go into the recipient nation's foreign exchange reserves which then may be supplied to foreign exchange markets, they cannot be tracked to determine who actually receives the money. In some cases, the IMF funds may be used merely to increase the level of foreign exchange reserves, since the IMF usually requires a certain level of foreign exchange reserves to be maintained by a country as a condition of its loan.

The World Bank and Asian Development Bank operate more on a project basis. They are development banks. They lend their funds directly to the recipient nation for specific projects at an interest rate and repayment schedule they determine. Projects may be for institution building such as modernization of the banking sectors in the

²The \$17.1 billion IMF support package for Russian announced on July 13, 1998, included \$11.6 billion in new loans from the IMF, \$4.0 billion from the World Bank, and \$1.5 billion from Japan.

³For background on the Exchange Stabilization Fund, see: CRS Report 98-583, *The Exchange Stabilization Fund of the U.S. Treasury Department: Purpose, History, and Legislative Activity*, by Arlene Wilson.

troubled Asian countries. **Table 2** shows total commitments and actual disbursements of funds by the IMF and the two development banks.

**Table 2. Actual Disbursements of Loans as Part of the
IMF-led Asian Financial Support Packages**
(As of August 30, 1998, Amounts in U.S.\$Billion)

	Thailand	Indonesia	South Korea
Total Pledged	\$17.1	\$36.6	\$58.2
IMF Disbursements (Date and Amount)	(8/20/97)\$1.6 (12/8/97)\$0.81 (3/5/97)\$0.27 (6/10/98)\$0.135 Total: \$2.8	(11/5/97)\$3.040 (5/4/98)\$0.989 (7/15/98)\$1.000 (8/25/98)\$1.000 Total: \$5.989	(12/4/97)\$5.56 (12/18/97)\$3.5 (12/30/97)\$2.0 (1/8/98)\$2.0 (2/17/98)\$2.0 (5/29/98)\$2.0 Total: \$17.06
World Bank Disbursements	(9/11/98)\$0.015 (12/23/97)\$0.350 (2/26/98)\$0.015 (7/9/98)\$0.300 (7/9/98)\$0.400 Total: \$1.080	(7/97)\$0.0425 (11/19/97)\$0.0345 (12/4/97)\$0.0200 (3/4/98)\$0.0205 (4/1/98)\$0.3607 (6/2/98)\$0.2250 (7/2/98)\$1.0000 (7/14/98)\$0.0447 (7/29/98)\$0.0215 Total: \$1.769	(12/23/97)\$3.0 (3/27/98)\$2.0 Total: \$5.0
Asian Development Bank Disbursements	(12/22/97)\$0.300 (3/12/98)\$0.300 Ongoing projects in 1997\$0.269 (3/26/98)\$1.000 Total: \$1.869		(12/19/97)\$3.015 Total: \$3.015
Total Disbursements	\$5.749	\$7.758	\$25.075

Source: World Bank, Asian Development Bank Press and News Releases, *Wall Street Journal*. International Monetary Fund. The IMF's Response to the Asian Crisis. April 1998. On Internet at <<http://www.imf.org/external/np/exr/facts/asia.htm>>.

The financial crisis also has impaired the ability of these countries to obtain normal trade finance, such as letters of credit. This problem was addressed at a meeting of the financial leaders of the Group of Seven Industrialized Nations (G-7) on February 21, 1998, in which the leaders decided that the eighteen export credit agencies from eleven industrialized countries would work to provide trade financing support to the troubled Asian economies. The U.S. Export-Import Bank stated that it could commit up to \$3 billion in additional short-term financing in support of American products sold to South Korea, Thailand, and Indonesia. In January 1998,

the Bank also decided to expand the short-term insurance capacity for commercial banks in South Korea.⁴

Since East Asia accounts for 40% of total U.S. agricultural exports, the U.S. Department of Agriculture has been increasing its support for U.S. sales there. It has allocated/authorized export credit guarantees (under the Commodity Credit Corporation's GSM-102 and 103 programs) for fiscal year 1998 of \$100 million for Malaysia, \$300 million for Thailand, \$410 million for Indonesia, \$102 million for the Philippines, \$90 million for other Southeast Asia, and another \$1.5 billion for South Korea.⁵

On March 16, 1998, the Asian Development Bank (ADB) approved participation in a \$1 billion export financing facility for Thailand. The facility is to provide liquidity for Thai exporters whose operations have been hampered by lack of credit and consists of two loans to the Export-Import Bank of Thailand. The first loan consists of \$50 million from the ADB. The second is a syndicated loan (partially guaranteed by the ADB) of \$950 million fully underwritten and arranged by ten leading international banks.⁶

The Role and Operations of the IMF

Among the international institutions, the focus of the IMF is on maintaining a stable, accessible, and transparent system of buying and selling of currencies in order that payments and other currency flows can take place among countries smoothly and without delay. It is a cooperative monetary institution of 182 members that specializes in the system of buying and selling of currencies and in assisting, when necessary, its member countries to develop the financial infrastructure that supports those flows. It serves as a lender of last resort for its members, much like a central bank does for nations. In emergencies, it lends hard currencies to members facing severe financial difficulties but only on condition that they undertake economic reforms that address the causes of their troubles. The IMF has authority to require its members to disclose information on monetary and fiscal policies and to avoid, as far as possible, putting restrictions on transactions in foreign exchange or on making payments to other members. It also reviews world economic and financial trends and

⁴U.S. Export-Import Bank. Ex-Im Bank Working in Support of 18 Country Export Credit Agency Trade Finance Initiative to Stabilize Asian Markets. Press Release. February 23, 1998. Available on Internet at <<http://www.exim.gov>>.

⁵U.S. Department of Agriculture. Foreign Agricultural Service. \$400 Million More in Credit Guarantees For Republic of Korea. News Release. April 20, 1998. \$1 Billion in Credit Guarantees Available for Southeast Asia, FAS Release PR 0004-98. January 5, 1998. On Internet at <www.fas.usda.gov>.

⁶Asian Development Bank. ADB Approves \$1 Billion Export Financing Facility for Thailand. News Release No. 22/98, 26 March 1998. On Internet at <www.asiandevbank.org/news98/nr022-98.htm>. The ten banks are: ABN-AMRO Bank N.V.; The Bank of Nova Scotia Asia Limited; the Bank of Tokyo-Mitsubishi Limited; Banque Nationale de Paris, Singapore Branch; Barclays Capital; Citicorp Investment Bank (Singapore) Limited; The Development Bank of Singapore Limited; DKB Asia Limited; The Industrial Bank of Japan Limited; and Sakura Finance Asia Limited.

may warn countries of what it sees as their emerging financial problems. It collects data and analysis and promotes modernization and liberalization of national financial sectors. The IMF claims to have learned from the Mexican Peso crisis in 1995 and has instituted emergency procedures that has enabled it to respond more quickly to the crises in Asia.

The mission of the IMF differs from that of other international economic institutions. The IMF is not a development bank, such as the World Bank (IBRD), Asian Development Bank (ADB), and other regional development banks that focus primarily on lending to poorer nations for specific development projects. It also differs from the Bank for International Settlements (BIS) which is an international bank that is owned and controlled by central banks. BIS provides specialized central banking services, promotes cooperation among central banks, and fosters financial stability among the major industrial countries. The IMF also has a different mission from the World Trade Organization (WTO) which deals primarily with trade in goods and services.

In place of the IMF, nations (such as the United States, members of the European Union, or Japan) with support from BIS, might have been able to coordinate the financial support packages as the “Asian flu” spread, but individual nations are subject to the constraints of domestic politics and diplomacy. The United States, for example, did not participate in the initial financial support package for Thailand. After the extent of the crisis and the economic and security threats to the United States became more apparent, the U.S. government joined in promising financial resources in the Indonesian and South Korean packages, but the IMF negotiators and specialists (along with U.S. Treasury officials) played the chief role in determining the needs, conditions, and reforms necessary in the borrowing countries. By relying on the IMF, the United States has been able to influence the outcome of the negotiations without committing large financial resources to provide support for the borrowing nations. The United States has been able to exercise power at relatively low cost. U.S. backup loan commitments under the IMF support packages are yet to be activated.⁷ (Of course, U.S. influence in the IMF also carries the potential for the United States to be blamed for any failures of the IMF or for the economic hardship that arises in nations that have borrowed from the IMF.

As the crisis developed, Japan attempted to establish a \$100 billion emergency fund for Asia. It, however, was rebuffed by other nations, particularly the United States, but also by its Asian neighbors who were wary of Japan’s intentions. There also were questions about how the fund would operate and its relation to the IMF.

The policy questions with regard to the IMF span a broad gamut from whether it should exist at all to what its level of funding should be and how it should operate in order to accomplish the goals of international financial stability and growth in world trade and investment. In the 105th Congress, H.R.3090 (Paul) would require the withdrawal of the United States from the International Monetary Fund.

⁷See: Davis, Bob. With GOP Support for the IMF Weakening, Danger Is the Slow Erosion of U.S. Leadership Globally. *The Wall Street Journal*, April 27, 1998. P. A24.

The Asian financial crisis has raised several questions pertaining to IMF operations. The first is whether such crises have increased in scale and whether IMF resources are sufficient to cope with them. The second is whether the Fund's willingness to lend in a crisis contributes to moral hazard (a tendency for a potential recipient country or investors to behave recklessly knowing that the IMF may bail them out in an emergency). The third is whether the contagion of financial crises can be stopped effectively. The fourth is conditionality — whether the changes in economic policy and performance targets that the IMF requires of the recipient countries are appropriate and effective. The fifth is transparency — whether the IMF releases sufficient information to the public, including investors, to allow for accurate assessment and accountability — especially with respect to IMF program design and provisions imposed as a condition for borrowing. The sixth is prevention — whether the IMF has sufficient leverage over non-borrowing member countries to prevent financial crises from occurring.⁸

IMF Resources

With respect to the available IMF resources and scale of financial crises, it is clear that recent liberalization of capital markets and advances in telecommunications have increased the scale of financial crises. The size of the support packages for South Korea and Indonesia have been unprecedented. The question is whether the IMF has sufficient resources to handle more financial crises, particularly if they occur simultaneously.⁹ A related issue is whether the IMF should be denied any additional funding as a way to express disapproval of its handling of the financial crisis.

As for IMF resources, the ratio of the IMF's uncommitted and adjusted liquid resources to its liquid liabilities — its so-called liquidity ratio — had fallen from 120.5% at the end of April 1997 to 47.8% at the end of December 1997.¹⁰ Further deterioration has occurred in 1998. This implies that the IMF has half or less than the amount of liquid resources it needs to meet its liquid liabilities. An April 1998 article in the *Wall Street Journal* estimated that after making the loans to deal with the Asian crisis, the IMF would have another \$13 billion or so in capital plus a \$24 billion credit line to deal with other emergencies.¹¹ Considering the \$20.9 billion in IMF support for South Korea alone plus a new commitment of \$11.2 billion for Russia, the IMF is left with arguably inadequate resources to deal effectively with a possible spread of the financial crisis or other emergencies. In funding the support for Russia, the IMF activated its general arrangements to borrow.¹²

⁸See also: CRS Report 98-56, *The International Monetary Fund's (IMF) Proposed Quota Increase: Issues for Congress*, by (name redacted).

⁹For a detailed discussion of IMF resources, see: CRS Issue Brief 97038, *The International Monetary Fund's Proposed Quota Increase and "New Arrangements to Borrow (NAB)*, by (name redacted).

¹⁰*Ibid.*, p. 9.

¹¹Davis, Bob. With GOP Support for the IMF Weakening, Danger Is the Slow Erosion of U.S. Leadership Globally. *The Wall Street Journal*, April 27, 1998. P. A24.

¹²International Monetary Fund. IMF Approves Augmentation of Russia Extended (continued...)

In the United States, the primary legislative issue related to the IMF and the Asian financial crisis revolves around a total of \$17.9 billion from the United States for an increase in the IMF's capital base and in a further line of credit. The IMF has asked for a \$14.4 billion increase in its quota (capital base) and for a \$3.5 billion increase in a line of credit (New Arrangements to Borrow) to be used in emergencies. The IMF quotas provide the financial resources from which the IMF extends loans to financially troubled member nations. In addition to determining the size of the IMF's capital and members' contributions, quotas also determine a member country's voting power and, in part, its access to IMF loans, and share in allocations of Special Drawing Rights (SDRs, the international reserve asset created by the IMF).

On September 21, 1997, the Interim Committee of the IMF announced an agreement to increase overall IMF quotas by 45%. This proposal was finalized in late December 1997 and adopted by the IMF on February 6, 1998. Total IMF quotas would increase from about SDR 146 billion (about \$197 billion, as of April 9, 1998) to SDR 212 billion (\$287 billion).

The U.S. portion of the IMF quota would increase by 40%, from SDR 26.5 billion (\$36 billion) to SDR 37.1 billion (\$50 billion), an increase of about \$14.4 billion. At the same time, the U.S. share of the total IMF quota would drop from 18.1% to 17.5% which would still be sufficient to enable it to veto major IMF decisions (which require an 85% majority vote). The voting power of members is determined by their quota shares.

In addition to the request for approval of U.S. participation in the quota increase, Congress is considering a request for an increase in its credit line to the IMF of \$3.5 billion called "New Arrangements to Borrow" (NAB). The NAB are an arrangement of medium-term credit lines that the IMF may borrow against to supplement its resources in the event of a financial crisis that requires additional liquid resources. Commitments to the NAB from 25 participant nations total about \$46 billion of which the U.S. share would be \$9.0 billion (counting the additional \$3.5 billion). In the 105th Congress, H.R.1171 (Kasich) would declare the sense of Congress that the United States should not participate in the NAB.

If the United States does not fund its share of the quota increase or the NAB, its 18.1% of the voting shares means that, in effect, the 85% majority vote would not be achieved and either funding increase would be disapproved at the IMF level. Other countries also would likely not provide their shares of the funding.

On March 26, 1998, the Senate passed S. Amendment 2100 to S.1768 (105th Congress), the Supplemental Appropriations Bill. This would have provided for both the \$3.5 billion for the NAB and \$14.4 billion for the IMF quota increase (with certain conditions). On March 31, the Senate passed H.R. 3579 with the language of S. 1768, as amended. The Conference committee, however, did not include the IMF funding in the final bill. On September 2, 1998, the Senate passed S.2334

¹²(...continued)

Arrangement and Credit under CCFB; Activates GAB. Press Release No. 98/31, July 20, 1998.

(McConnell), the Foreign Operations FY99 Appropriations bill, which includes IMF funding. The House is considering other legislation (H.R. 3580, Livingston [Supplemental Appropriations Bill] as well as H.R. 1293 [Kennedy], H.R. 3114 [Leach] and H.R.3287 [Frank]) that would provide funding for the IMF.

Under current budgetary treatment, U.S. quota subscriptions to the IMF are considered to be an exchange of assets. Both the quota increase and NAB must be authorized and appropriated (because of congressional concern at the time this budgetary rule was made over the rising fiscal deficit and off-budget spending), but neither would result in a net budgetary outlay nor have any effect on the Federal budget deficit or surplus. IMF funding also would increase the budget's discretionary spending limits in order not to preclude other spending.¹³

One question with respect to the IMF resources is whether it should be required to borrow on international capital markets rather than rely on quota subscriptions and lines of credit from member nations. The World Bank and Inter-American Development Bank both sell bonds on international markets in order to raise funds for their operations. In this respect, H.Con.Res 207 (Saxton, 105th Congress) expresses the sense of the Congress that the IMF should raise funds in private financial markets through the sale of bonds or notes, rather than from member countries, in order to reduce the risk of loss to U.S. taxpayers.

Moral Hazard

Moral hazard refers to the tendency for something that is designed to alleviate the ill effects of risky decisions to encourage more risky decisions to be made. In the international financial context, it refers to the tendency for borrowers and lenders to behave less prudently knowing that the IMF or their respective governments may bail them out if the loans turn sour. Even supporters of the IMF recognize that the very existence of the IMF may encourage countries to borrow excessively on international markets and for lenders to act imprudently..

The IMF, points out, however, that governments in trouble usually are too slow in approaching the Fund for help because of the conditions the IMF places on such support. Even some countries with severe currency difficulties, such as Malaysia in 1997, will do almost anything to avoid having to swallow the "bitter IMF medicine." According to the IMF, the real moral hazard is not with governments (particularly quasi-governmental banks) engaging in unsound borrowing and lending but that, because IMF support is available, the private sector may be too willing to borrow and lend. Private sector financial institutions know that a country in trouble will go to the Fund rather than default on international loans.¹⁴

¹³ More details on U.S. budgetary treatment of the IMF may be found in: CRS Report 96-279, *U.S. Budgetary Treatment of the International Monetary Fund*, by (name redacted).

¹⁴Boorman, Jack. The Changing Emphasis of the Fund, Implications for Stabilization and Growth Policies. Paper presented at the IMF Seminar, Asia and the IMF. September 19, 1997. Hong Kong.

Others, moreover, assert that the IMF is perpetuating the moral hazard that lies at the heart of the problem for troubled economies like South Korea. By providing support for countries in financial trouble, the IMF may be allowing their governments to use other resources to prop up companies that essentially are insolvent. Some governments have not allowed certain favored corporations to fail because of political or other connections. In the words of one commentator, "Capitalism without bankruptcy is like Christianity without hell. There is no systematic means of controlling sinful excesses."¹⁵ This type of moral hazard certainly existed in the troubled Asian countries. Banks may continue to lend to corporations in difficulty on the prospect that they will receive government assistance. In other cases, the government, itself, may channel funds to troubled companies from private or quasi-governmental financial institutions. The Bank of Thailand, for example, revealed that it had spent or otherwise committed about \$25.5 billion between mid-1996 and March 1998 to prop up troubled Thai financial institutions — most of which it later shut down. It claimed that it had been acting "on orders" given by two successive finance ministers.¹⁶ In South Korea, when the Hanbo steel venture collapsed in 1997 with \$5.8 billion in debts, it was found that government officials has exerted pressure on banks to provide loans to Hanbo in return for illegal political contributions.

One solution to the problem of moral hazard is to ensure that imprudent lenders or investors in the recipient countries do not escape real losses. This has been happening to a large extent. International banks, for example, face large potential and real losses from their operations in Asia. For example, in 1997, the Asian turmoil reduced Citicorp's pretax earnings by about \$250 million.¹⁷ The Bank of America reported that as of December 31, 1997, it had assets of \$24.0 billion in Asia (up from \$20.4 billion in December 1996), but net income from Asia had dropped from \$224 million in 1996 to -\$218 million in 1997.¹⁸ During the fourth quarter of 1997, J.P. Morgan designated as nonperforming approximately \$587 million of its total \$5.4 billion in loans, swaps, and debt investment securities in Indonesia, Thailand, and South Korea. The bank reported charge-offs of \$24 million during the quarter — mostly related to Asia, and considered about 60% of its total allowance for credit losses of \$1.081 billion to be related to exposures in the three troubled Asian countries.¹⁹ As for investors in equity markets, they also have incurred major losses. In January 1998, U.S. Federal Reserve Chairman Alan Greenspan stated that U.S. investors in Asian stock markets (excluding those in Japan) had lost an estimated \$30 billion.²⁰

¹⁵South China Morning Post, January 8, 1998. P. 3.

¹⁶Bangkok Discloses Lending to Banks. *Wall Street Journal*, March 5, 1998. P. A18.

¹⁷Citicorp. Fourth Quarter Report. January 20, 1998. P. 1.

¹⁸Bank of America. BankAmerica Fourth Quarter 1997 Earnings. January 21, 1998. P. 15.

¹⁹J.P. Morgan. Fourth Quarter and 1997 Full Year Results. January 1998. P. 4. Available on Internet at <<http://what.inet.jpmorgan.com/Corp...information/4qtr97earnings/summ.html>>.

²⁰U.S. Federal Reserve Board. Testimony of Chairman Alan Greenspan before the Committee on Banking and Financial Services, U.S. House of Representatives, January 30, 1998.

As for the domestic moral hazard and perceived lack of bankruptcy in some countries, this too has changed as the crisis swept through certain economies of Asia and the IMF imposed conditions aimed at strengthening financial sectors. In Korea, for example, the operations of 14 of 30 merchant banks have been suspended. The remaining merchant banks also are being monitored closely. In Indonesia, 16 insolvent banks have been closed, and weak but viable banks have been required to submit rehabilitation plans. In Thailand, 56 of 91 finance companies are being liquidated.

One question is whether the IMF loans are used to bail out international banks, including American banks, that have made loans to the troubled Asian economies that in retrospect seem imprudent. There is little doubt that banks which have loans outstanding in Asia have much to gain by a return to stability in financial markets there. To the extent that the IMF support packages have contributed to that stability and to the extent that the infusion of dollars by the IMF has enabled borrowers to purchase foreign exchange needed to make loan repayments, the losses by U.S. banks and other creditors have been stemmed.

The IMF insists, moreover, that its assistance has been provided to support programs that are designed to deal with economy wide, structural imbalances and not to protect commercial banks and private investors from financial losses.²¹ A more stable exchange rate may contribute to a recovery on stock markets or better business conditions, but there is no IMF “bailout” of specific investors. Since IMF loans are used primarily to augment foreign exchange reserves of the borrowing nations, they become intermingled with existing reserves. Foreign exchange from the IMF is usually sold through local foreign exchange dealers for local currencies. The IMF does not loan directly to private companies.

As for bailouts of manufacturing or other nonfinancial corporations, the IMF claims that there are no provisions in the IMF-supported programs for public-sector guarantees, subsidies, or support for them. Shareholders and creditors bear losses, although individual governments may devise separate policies for dealing with such cases. Any company in need of foreign exchange, however, usually is better off when foreign exchange markets are stabilized.

As for financial corporations, the IMF recognizes that governments often guarantee accounts of certain categories of depositors (deposit insurance). Governments also can provide liquidity support to undercapitalized, but solvent, financial institutions. According to the IMF, however, such support normally requires

²⁰(...continued)

Available on the Internet at <<http://www.bog.frb.fed.us/boarddocs/testimony/19980130.htm>>.

²¹International Monetary Fund. IMF Bail Outs: Truth and Fiction. January 1998. Available on the Internet at: <<http://www.imf.org/external/np/exr/facts/bailout.htm>>.

that institutions be capable of actually being recapitalized and restructured to restore them to health.²²

Contagion

With respect to contagion, the track record of the IMF in stopping the spread of the financial crisis has not been reassuring. The size of the global capital flows underlying the crisis along with the extent of structural problems uncovered in the economies of the troubled nations seem to reach beyond the ability of the IMF handle completely. The total of \$26 billion in IMF loans to Thailand, Indonesia, and South Korea is small when compared with the total foreign exchange needs of these nations and the billions of dollars that flow through foreign exchange markets each day.

For the first year of the Asian financial crisis, the problems seemed to have been confined largely to Asia. During the summer of 1998, however, Russia had to devalue its ruble even further, Japan's yen and its economy continued to weaken, China intimated that it might devalue its currency, values had dropped on stock markets worldwide, and economic forecasts were becoming more and more pessimistic. According to Standard & Poor's DRI, the major reason for the more pessimistic outlook was that Asian exports were doing more poorly than had been anticipated. They also indicated that the Japanese yen could depreciate even further, a devaluation of the Chinese renminbi was "almost a certainty," the insolvency problems of corporations and financial institutions throughout the Asian region appear to be much more ominous than previously imagined, anti-Chinese turmoil in Indonesia was driving away capital, the collapse of regional tourism had undermined service-sector growth in nearly every country in the region, and the severe decline in the international prices of primary commodities had severely reduced incomes in the agricultural and mining sectors of many Southeast Asian nations.²³

The fall in the price of crude petroleum, copper, and other commodities also was undermining the export income of Russia, Mexico, Venezuela, Chile, and other commodity exporting countries. The drop in values on stock markets in late August along with speculative attacks on the currencies of nations such as Russia, Venezuela, and Mexico have added to the uncertainty in world markets. A risk still exists not only for the financial crisis to worsen in Asia but for it to spread to other countries of the world. The Asian financial crisis may become global.

Conditionality

IMF conditionality refers to the "strings attached" to its lending. Opinions on conditionality are diverse and can be intense. Although the IMF provides support to the very countries who also are its owners and managers, the support comes with powerful strings attached. Not only is the financial assistance extended in the form of loans that carry a rate of interest and must be repaid, but the loans are disbursed in installments with each disbursement dependent on the borrower meeting the

²²*Ibid.*

²³Standard & Poor's DRI. *International Financial Bulletin*, August 1998. P. 3.

performance criteria and receiving favorable reviews by IMF officials. In the United States, much of the controversy associated with the legislation to provide additional funding for the IMF centers on the conditions that the IMF may or may not impose upon the recipient nations.

According to IMF policy, IMF conditionality is to be applied only in areas that relate to the recipient country's macroeconomic performance. The IMF Articles state that performance criteria "will normally be confined to (i) macroeconomic variables, and (ii) those necessary to implement specific provisions of the [IMF's] Articles...." Performance criteria may relate to other variables only in exceptional cases when they are essential for the effectiveness of the member's program because of their macroeconomic impact.²⁴

In practice, most microeconomic policies can be interpreted to have some macroeconomic effect. In the Indonesian support package, for example, the IMF conditions required that the country restructure certain banks, dismantle a quasi-governmental monopoly on all commodities (except rice), cut fuel subsidies, increase electricity rates, increase the transparency of public policy and budget-making processes, and speed up privatization and reform of state enterprises.²⁵ The IMF, however, did not require action on human rights or security policy, two controversial areas less closely linked to Indonesia's macroeconomy.

In the South Korean support package, the IMF required numerous macroeconomic and financial conditions, and it also required the Korean government to undertake several microeconomic or structural measures. These included reducing trade-related subsidies, increasing the ceiling for foreign investment in listed Korean firms, liberalizing other capital account transactions, and easing labor dismissal restrictions under mergers and acquisitions and corporate restructuring.²⁶

The controversy over IMF conditionality extends in two directions. The first is whether the monetary and fiscal policies required by the IMF are too stringent and slow economic growth too much in the recipient countries. The World Bank, in particular, reportedly fears that the slowdown in economic growth in the troubled Asian economies will only worsen their economic problems.²⁷ As non-Asian economies, such as Russia, Mexico, and Venezuela, have been buffeted by currency and stock market weakness, the critics of the stringent IMF conditions have become

²⁴International Monetary Fund. Guidelines on Conditionality. Decision No. 6056-(79/38), March 2, 1979. In *Selected Decisions and Selected Documents of the International Monetary Fund*, 22nd Issue. Washington, D.C., 1997. P. 118.

²⁵International Monetary Fund. IMF Approves Stand-by Credit for Indonesia. Press Release No. 97/50, November 5, 1997.

²⁶International Monetary Fund. IMF Approves SDR 15.5 Billion Stand-By Credit for South Korea.

²⁷Davis, Bob and David Wessel. World Bank, IMF at Odds over Asian Austerity. *Wall Street Journal*, January 8, 1998. P. A5, A6. See also: Pearlstein, Steven. Tiff in the Economists' Temple. *Washington Post*, April 5, 1998.

more vocal. Some claim that the IMF has actually made conditions worse. The IMF has been sensitive to these criticisms and has eased the requirements for Thailand and Korea.²⁸ One measure of whether the IMF conditions are too onerous is the performance of Malaysia. Malaysia has avoided an IMF support package but has been subject to the same market pressures as its neighbors, Thailand, Indonesia, and South Korea. As shown in **Figure 5**, however, Malaysia's economic performance, however, has not been too different from that of Thailand and South Korea, both of which are under IMF austerity programs.

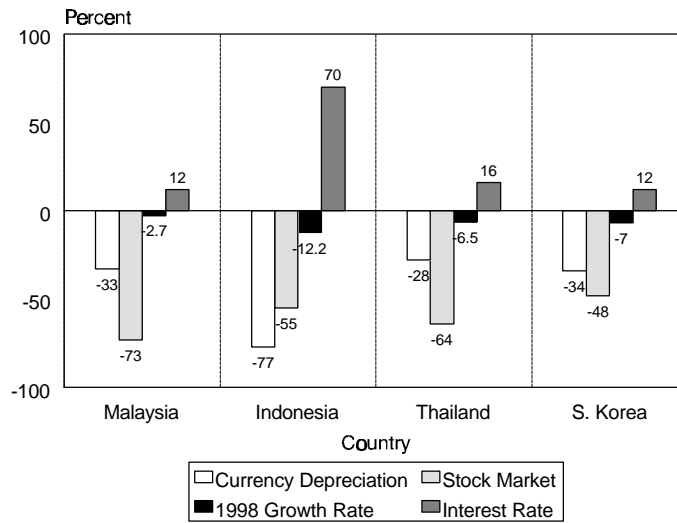
Another IMF condition that is opposed by some in the United States is requiring tax increases by borrowing countries. This is intended to reduce fiscal deficits and to promote currency stability.

Others claim that the IMF should focus on its traditional task of helping countries cope with temporary shortages in foreign exchange and with sustained trade

deficits rather than imposing major structural and institutional reforms at all.²⁹ They assert that the IMF does not have the expertise or resources to intervene to such an extent in the economies of borrowing nations.

The second direction of controversy relating to IMF conditionality is whether the United States should use its voice and vote in the IMF to press for certain conditions to be imposed or to drop certain conditions from IMF programs. Currently, there are about 30 voice-and-vote requirements in U.S. statutes that direct the U.S. Executive Director of the IMF to promote certain desired changes.³⁰ Typical of these is the

Figure 5. Currency and Stock Market Declines (Since July 1997), Estimated Growth Rates for 1998, and Prime Interest Rates (August 1998) for Malaysia, Indonesia, Thailand, and S. Korea



Source: Congressional Research Service

²⁸International Monetary Fund. IMF Executive Board Completes Second Review of Thailand's Economic Program. News Brief No. 98/5, March 4, 1998. P. H1. Seoul, IMF Agree to Lower Rates to Curb Insolvencies, Create Jobs. *Wall Street Journal Interactive Edition*, April 27, 1998. On Internet at <<http://interactive.wsj.com>>.

²⁹Feldstein, Martin. Refocusing the IMF. *Foreign Affairs*, March/April 1998. P. 20. Montes, Manuel. Global Lessons of the Economic Crisis in Asia. *Asia Pacific Issues*, No. 35, March 1998.

³⁰CRS Report 98-391. *The IMF and "Voice and Vote" Amendments: A Compilation*, by (continued...)

Frank-Sanders amendment (U.S.C. 22 § 262p-4p). Among its provisions, this law requires the U.S. Executive Directors of the International Financial Institutions to use their voice and vote to urge their respective institution to adopt policies to encourage borrowing countries to guarantee internationally recognized worker rights and to include such rights as an integral part of the institution's policy dialogue with each borrowing country.

In the 105th Congress, S.2334 (McConnell), the Foreign Operations FY99 Appropriations bill, includes provisions that would require G-7 countries to support a requirement that borrowing countries liberalize restrictions on trade consistent with trade agreements and also would require borrowers to eliminate government directed lending on non-commercial terms, remove discriminatory treatment between foreign and domestic creditors in its debt resolution proceedings, adopt modern bankruptcy laws, and for the IMF to increase the transparency of its operations. The bill also would establish an International Financial Institution Advisory Commission to examine consolidating the IMF, World Bank, and World Trade Organization; require the Administration to provide certain reports to Congress and certify that no IMF resources have resulted in support to the semiconductor, steel, automobile, or textile and apparel industries. H.R. 3580 (Livingston, Emergency Supplemental Appropriations) and H.R. 3114 (Leach, 105th Congress) also include similar and additional provisions.

One question that has been raised concerning IMF conditionality is whether it can require trade liberalization that goes beyond that which is necessary under World Trade Organization agreements. In this respect, the IMF's "Guidelines/ Framework for Fund Staff Collaboration with The New World Trade Organization" (adopted by the IMF in 1995) states that policy measures and program conditionality should be consistent with the member's agreements under the auspices of the WTO. The Guidelines also state that IMF policy advice, however, often encompasses features that require reforms that may go beyond a member's undertakings in the WTO. For example, trade barriers or subsidies may be reduced under an IMF-supported program below the levels required under the relevant WTO agreements, but they cannot be raised above the WTO-required levels. The Guidelines further state that IMF-supported programs should avoid directly linking the use of IMF resources to the performance of obligations under the WTO-administered agreements.³¹

Transparency

Critics of the IMF claim that the institution does not release sufficient data to the public — particularly to investors who have financial interests in the success or failure of the IMF support packages and who need more information to devise effective

³⁰(...continued)
(name redacted) and Pamela Hairston.

³¹International Monetary Fund. Guidelines/ Framework for Fund Staff Collaboration with The New World Trade Organization, Decision No. 10968-(95/43), April 21, 1995. In *Selected Decisions and Selected Documents of the International Monetary Fund*, 22nd Issue. Washington, D.C., 1997. P. 468-69.

strategies to cope with the crises.³² A problem in the current environment of insufficient information and data is that certain information from the IMF could precipitate a crisis if investors reacted en masse. The IMF, therefore, has released certain detailed information only with the concurrence of the pertinent country. Recently, the IMF has tried to disclose more information that it did previously. Its press releases and speeches by IMF officials now contain more data and analysis. Other documents have been made public with permission. For example, the Supplemental Memorandum of Economic and Financial Policies agreed to between the IMF and Indonesia on April 10, 1998, was released by the IMF only with the permission of the government of Indonesia. The bills in the 105th Congress that would provide additional funding for the IMF include provisions on transparency.

Prevention

With respect to prevention, the IMF has little leverage over member countries who are not borrowers. Political parties facing re-election, moreover, may inflate the domestic economy or may be reluctant to take harsh measures for fear of losing the election. For example, prior to the financial crisis in Thailand, even though the IMF claims to have warned the country that it was headed for trouble, Thai leaders faced great difficulty in mustering the political support to restructure the 58 financial institutions that eventually became insolvent. Also, before their currency crises, both Mexico and South Korea held presidential elections. IMF is now reportedly exploring a system in which it would issue increasingly severe warnings to nations whose economic policies are seen as “seriously off course.” The Fund would issue warnings as private communications with member nations but would consider making them public in certain circumstances.³³

Effects on the U.S. Economy

The Asian financial crisis affects the U.S. economy both in a macroeconomic and microeconomic sense. On the macroeconomic level, it is affecting the U.S. growth rate, interest rates, balance of trade, and related variables. On a microeconomic level, it is affecting specific industries, each in a different way depending on their relationship to the troubled Asian economies.

A danger exists that the Asian financial turmoil may turn into a worldwide crisis. In August 1998, Russia and certain countries of Latin America were experiencing currency weakness and a drop in values on their stock markets similar to that experienced in Asian countries. In many respects, Russia appears to be in a situation worse than that of Asian nations because its fundamental economic structure is weaker. The current recession (depression in some countries) in Asia could evolve into a world recession that would affect the United States directly.

³²See, for example, Sachs, Jeffrey. Power Unto Itself. *Financial Times*, December 11, 1997. P. 11.

³³Blustein, Paul. IMF Seeks to Be More Forceful in Approach to Crisis. *Washington Post*, April 18, 1998. P. D1.

The mechanism by which the Asian financial crisis affects the U.S. macroeconomy is through trade, capital flows, and investor confidence. The depreciation in the values of the Asian currencies (except for the Hong Kong dollar and Chinese RMB) combined with a slowing of growth and financial difficulties of banks and manufacturing corporations in these countries is expected to increase the U.S. trade deficit by about \$65 billion. In the Asian countries, the immediate effect of the change in the value of their currencies and outflows of capital is to reduce their trade deficits, and, in some cases, to generate a trade surplus. Much of this increased trade surplus for Asia appears to be coming at the expense of the United States.

The second macroeconomic mechanism by which the Asian financial crisis affects the U.S. economy is through capital flows. As the contagion began and Asian banks and corporations began to face severe financial difficulties, a concern arose in the United States that Asian holders of American financial assets, particularly U.S. Treasury securities, might be forced to dispose of them in order to generate much needed cash or that foreign central banks might sell them as part of their intervention to support their respective currencies.³⁴ This has occurred to some extent. It seems, however, that a “flight to quality” has more than offset this activity. Both American and foreign investors withdrew liquid capital (by selling securities and not rolling over loans) from the troubled Asian countries and moved the funds into safer markets like those in the United States. The appreciating U.S. dollar also has made U.S. investments more attractive. This influx of capital has eased the upward pressure on U.S. interest rates and has had a positive effect on U.S. economic growth. The capital flows, however, have caused some volatility on U.S. stock markets.

Economic Growth

The Asian financial crisis has slowed down U.S. economic growth directly and indirectly through its negative effects on world economic growth. In April 1998, the IMF reduced its projections for world output growth for the year to just over 3% which is down from 3.5% it projected in December 1997 and 4.25% it projected three months earlier in October 1997. This lower world growth is being caused by downward revisions in the outlook in the three economies most affected by the crisis — Indonesia, South Korea, and Thailand — and also more pessimistic outlooks for Malaysia, the Philippines, and Japan.³⁵

Other forecasts parallel those in the IMF outlook. **Table 3** shows forecasts for several countries for 1998 and 1999. These forecasts were made before the Russian crisis in August 1998, and, therefore, are probably on the optimistic side for most countries. The worst economic performance is expected in the troubled Asian economies with Indonesia, Thailand, South Korea, Hong Kong, and Japan in recession with negative growth rates in 1998. The outlook for each of these

³⁴Much of the foreign central bank reserves of foreign exchange is kept in the form of U.S. Treasury securities under the custody of the U.S. Federal Reserve. When the Bank of Japan, for example, intervenes to support the yen, it may sell some of its Treasury securities for dollars and use those dollars to buy yen.

³⁵International Monetary Fund. March 1998 *World Economic Outlook*. P. 1. On Internet at <<http://www.imf.org>>.

economies has worsened during 1998. The rest of Asia seems to be weathering the storm with Hong Kong and Singapore expected to grow by 2 to 3% and Taiwan and China to log growth rates more than twice as high. Economic recovery in Europe is expected to continue.

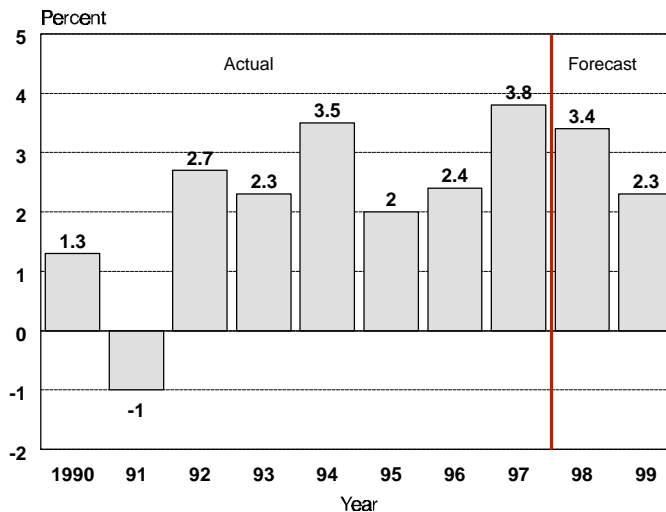
Table 3. Outlook for Economic Growth (Change in Real GDP) in Selected Countries 1998 and 1999
(In Percent)

Country	1998	1999	Country	1998	1999
Indonesia	-15.0	-0.6	Taiwan	4.4	4.7
Thailand	-8.0	-1.0	China	6.3	6.4
S. Korea	-7.0	-1.0	United States	3.4	2.3
Japan	-1.1	1.1	Germany	2.7	2.7
Philippines	0	3.3	United Kingdom	2.2	1.9
Hong Kong	-1.5	1.6	Mexico	4.8	4.4
Singapore	1.1	2.9	Russia	-3.0	-6.0

Sources: Forecasts for Indonesia, Thailand, South Korea, and Philippines are from Goldman Sachs. Those for Russia are from Standard & Poor's DRI. Other forecasts from *Blue Chip Economic Indicators*, August 10, 1998.

As for the United States, American forecasters project that U.S. economic growth will slow slightly from 3.8% in 1997 to about 3.4% in

Figure 6. Growth in U.S. Real Gross Domestic Product 1990-99 (forecast)



Sources: Blue Chip Economic Indicators, U.S. Dept. of Commerce

1998.³⁶ (See **Figure 6.**) As 1998 has progressed, this forecast had risen from 2.5% in January to 3.1% in May. In April 1998, the Organisation for Economic Cooperation and Development projected U.S. economic growth to be 2.7% in 1998 and 2.1% in 1999.³⁷

The slowdown in U.S. economic growth is being caused primarily by two factors: the Asian financial crisis and tightness in U.S. labor markets. A comparison of forecasts for U.S. economic growth made in August 1998 with those made before July 1997, however, reveals one unexpected result. The forecasts for economic growth made after the crisis erupted are higher than those published in July 1997 before the onset of the troubles. The main reason for this seems to be that in mid-1997 forecasters were wary of the Federal Reserve Board's concern over the run-up in the U.S. stock market and tightening labor markets and thought it probable that the Federal Reserve would raise U.S. interest rates. These concerns were eased by the correction in the U.S. stock market in October 1997 and by the financial turmoil in Asia. After the market volatility in August-September 1998, the Federal Reserve is even less likely to raise interest rates soon. The rising U.S. trade deficit, therefore, is being offset by the easing of upward pressures on U.S. interest rates and higher than expected activity in interest-sensitive sectors, such as housing.

U.S. Merchandise Trade Deficit

Forecasters expect the 1998 U.S. merchandise trade deficit to increase significantly because of the drop in the value of currencies in Asia, net capital inflows, and the slowdown in growth in those economies. The capital inflows into the United States and outflows from the troubled Asian economies imply that the respective current accounts must move in the opposite direction. For the United States, a rise in the surplus in the capital account implies an offsetting rise in the deficit in the U.S. current account — most of which is trade in goods and services.³⁸

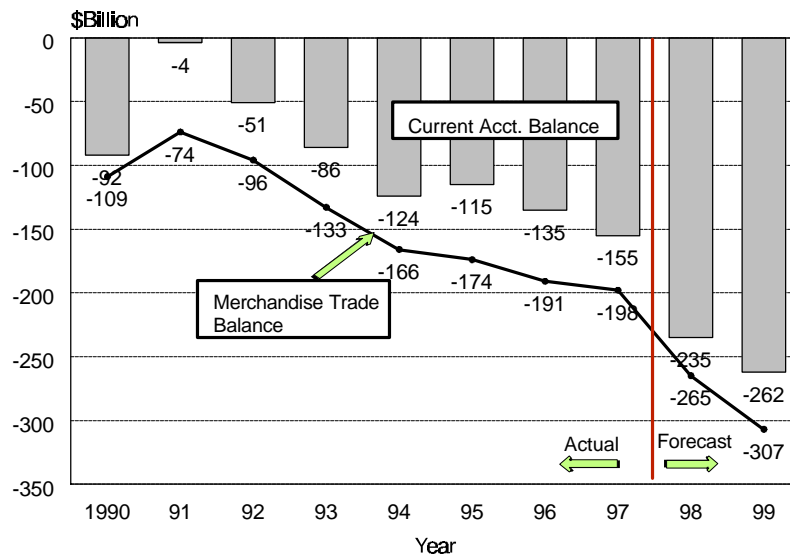
³⁶*Blue Chip Economic Indicators*. August 10, 1998. P. 2.

³⁷Organisation for Economic Cooperation and Development. *OECD Economic Outlook 63*, Preliminary Edition. April 8, 1998. On Internet at <<http://www.oecd.org>>.

³⁸Trade in goods and services plus income from foreign investments and unilateral transfers.

As shown in **Figure 7**, Standard & Poor's Data Resources, Inc. (DRI) expects the U.S. merchandise trade deficit (balance-of-payments basis) to increase by about \$65 billion from \$198.9 billion in 1997 to \$265 billion in 1998 and further to \$307 billion in 1999. DRI also expects the

Figure 7. U.S. Merchandise Trade and Current Account Balances, 1990-1999 (forecast)

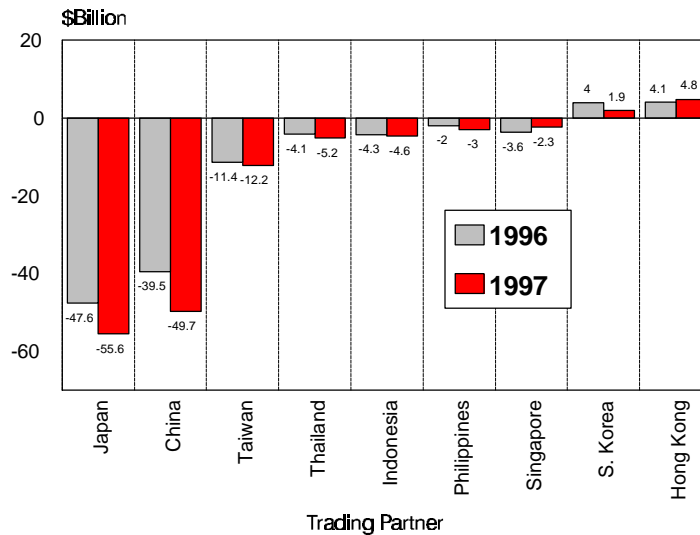


Sources: Actual data from U.S. Dept. of Commerce. Forecasts are from Standard & Poor's Data Resources Inc. *Review of the U.S. Economy*. August 1998. p. 94.

U.S. deficit on current account to rise by about \$80 billion from \$155 billion in 1997 to \$235 billion in 1998 and further to \$262 billion in 1999.³⁹

As shown in **Figure 8**, the United States has been experiencing a deficit in its merchandise trade with the Asian countries that have experienced currency problems — except for South Korea. With the exception of those for Singapore and Hong Kong, the deficits increased in 1997. The surplus with

Figure 8. U.S. Merchandise Trade Balances with Selected Asian Countries, 1996-97



Source: U.S. Department of Commerce

South Korea is expected to change to a deficit in 1998. The largest trade deficits, however, still are with Japan and China. While the Japanese yen has been weakening, Japan has not yet encountered a currency crisis, although that country faces severe

³⁹Standard & Poor's DRI. *Review of the U.S. Economy*, August 1998. P. 94.

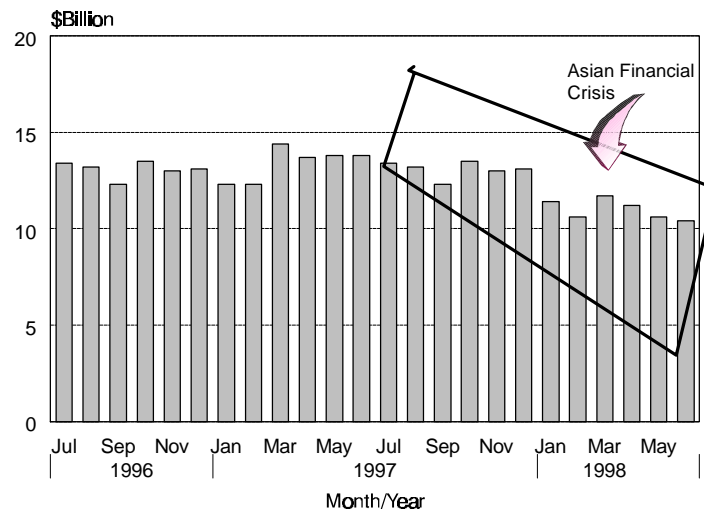
financial difficulties and a stagnant economy made worse by the financial crisis in neighboring countries. China has been holding the value of its currency stable.

What effect does intervention by the IMF and others to stabilize currency markets have on U.S. industries that compete with imports from Asia? On one hand, the intervention helps Asian companies, such as Samsung or Hyundai in Korea, meet their needs for foreign exchange and provides a more stable operating environment for them. This makes them more competitive relative to their U.S. counterparts. On the other hand, a currency that depreciates lowers the price for Asian exports relative to products made in America. IMF intervention to stabilize Asian markets and curb excessive currency depreciation, therefore, helps U.S. companies competing with imports from Asia by keeping import prices from falling even further.

U.S. Exports to Asia

U.S. export industries depend on Asia for more than a quarter of their foreign markets. The economic performance of the countries in Asia along with their exchange rates are a major determinant of how much they buy from American exporters. The rise in the U.S. deficit in trade with Asia, so far, is being caused more by a drop in U.S. exports there than by a rise in U.S. imports from those countries.

Figure 9. U.S. Merchandise Exports by Month to the Asian Eight: Indonesia, Japan, South Korea, Malaysia, Philippines, Singapore, Taiwan, and Thailand
July 1996-June 1998

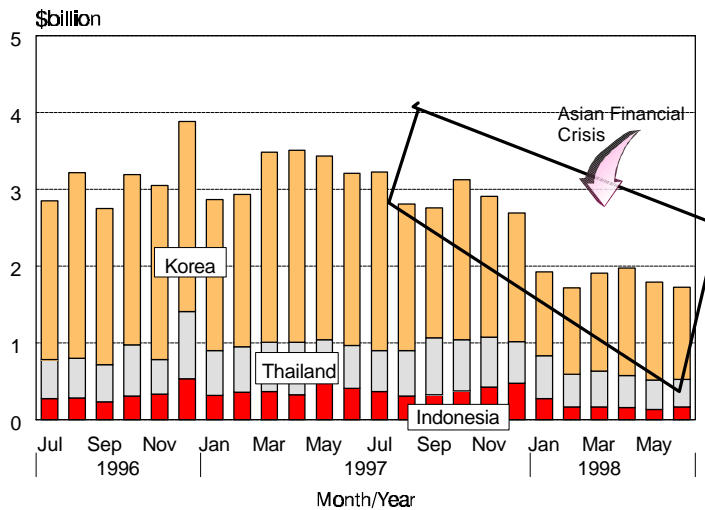


Source: U.S. Department of Commerce

Asian exporters' production has been constrained by a lack of foreign exchange to import raw materials and components and other disruptions to their operations. As conditions stabilize, however, production for export is expected to rise. **Figure 9** shows total U.S. exports of merchandise by month to eight of the Asian nations affected by the crisis (Indonesia, Japan, South Korea, Malaysia, the Philippines, Singapore, Taiwan, and Thailand). The fall-off in U.S. exports since the onset of the Asian financial crisis is apparent.

For the three recipients of IMF support packages (Thailand, Indonesia, and South Korea), the drop in U.S. exports associated with the Asian financial crisis is even more conspicuous. **Figure 10** shows U.S. merchandise exports to these three countries from July 1996 to June 1998. As the financial crisis affected the ability of these countries to

Figure 10. U.S. Merchandise Exports by Month to the Asian Three: Thailand, Indonesia, and South Korea July 1996-June 1998



Source: U.S. Department of Commerce

import, U.S. exports to Korea fell by 49% from \$2,326 million in July 1997 to \$1,196 million in June 1998. Likewise, U.S. exports to Indonesia declined by 52% from \$346 million to \$166 million, and U.S. exports to Thailand dropped by 33% from \$534 million to \$360 million over the same eleven-month period.

Microeconomic Effects

On a microeconomic level, the Asian financial crisis affects those industries most closely linked to the economies in question. The following provides a rough outline of the major U.S. sectors that may be affected.

- **U.S. creditors and investors in Asia** — U.S. banks, pension funds, and investors stand to lose on their pre-crisis exposures, but “bottom fishers” may gain as Asian equity markets recover and currencies strengthen.
- **U.S. exporters to Asia** — U.S. providers of major export items, such as heavy equipment, aircraft, manufacturing machinery, computers, and agricultural commodities (particularly soybeans, corn, lumber, and tobacco) are seeing Asian demand for their products decline. U.S. producers of commodities used in manufacturing processes in Asia also are experiencing soft prices (e.g. petroleum, chemicals, cotton, copper, and rubber).
- **U.S. businesses that compete with imports from Asia** — U.S. manufacturers of automobiles, apparel, consumer electronics, steel, and other products that compete with imports from Asia are likely to see increased competition and downward pressures on prices. Exporters from Korea, however, report that they are experiencing difficulty obtaining foreign exchange to finance imports needed in their production processes. This, in turn, constrains their exports. U.S. labor engaged in manufacturing competing products tend to be hurt by Asian exchange depreciation.

- **U.S. businesses related to interest rates** — mortgage bankers, refinancing companies, builders, and other businesses that benefit from lower rates of interest are seeing greater activity.
- **U.S. businesses the sell imports from Asia** — distributors and retailers of products from the troubled Asian economies are likely to have increased activity. These include discount retailers and Korean automobile dealers.
- **U.S. multinational corporations seeking market access in Asia** — U.S. companies, particularly in the financial sector, that have encountered barriers to entry or restrictions on their activities in Indonesia, Thailand, and South Korea are likely to benefit from the market opening required by the IMF support packages. They also may be able to buy existing firms that need restructuring and recapitalization at attractive prices.
- **U.S. multinational corporations with manufacturing subsidiaries in Asia** — Most U.S. companies with direct investments in the region will probably weather the storm, although some investments have been thrown into question. Since about 60% of the output from U.S. manufacturing subsidiaries in Asia is sold in the region, local sales are likely to stagnate until economic growth resumes. Some excess capacity may emerge. For a manufacturing subsidiary in a country with a depreciated local currency, its cost of imported components has risen, but the price of the finished export to the U.S. and other hard currency markets has fallen.
- **U.S. subsidiaries of companies from troubled Asian nations** — Companies from South Korea, in particular, with subsidiaries in the United States are being forced either to cut back operations or, in some cases, to sell their American subsidiary companies. Some Japanese banks also are selling certain subsidiaries in the United States (e.g. Sumitomo Bank's sale of 85% of the Sumitomo Bank of California to Zions Bank).
- **U.S. industries that use components from Asia** — U.S. manufacturers that use parts and other inputs from Asian countries whose currencies have depreciated (e.g. computer assemblers) are experiencing lower costs of production.

An overall indicator of the effect of the Asian financial crisis on U.S. businesses is the outlook for corporate profits. The increased competition from imports combined with rising wage costs in the United States is expected to reduce the growth in U.S. corporate profits in 1998 to about 1.6% (before adjusting for inflation) which is a significant decline from the 9.4% in 1997 or the 13.2% in 1996.⁴⁰ Lower profit growth by corporations tends to have a negative effect on their stock prices.

Japan's Economic Weakness

The Asian financial crisis also calls into question the actions by other nations to resolve the situation, particularly Japan. Japan plays a key role in the financial turmoil because it is the second largest economy in the world, its currency plays a large role in Asian trade, and its banks and businesses are major players in the economies of Asia. The problem with Japan is four-fold. First, the Japanese yen is weakening relative to the dollar. The weak yen was a primary cause of the overvaluation of the

⁴⁰*Blue Chip Economic Indicators*, August 10, 1998.

Asian currencies (which had been tied to the dollar) that led to the drop in their values. Second, Japan's economy, with the exception of 1996, has been virtually in recession since 1991. This weak domestic economic activity has depressed the market for other exports from other Asian countries. Third, Japan's financial sector, particularly its banks, face a massive problem with nonperforming loans that the government and financial institutions have been slow to resolve. This banking problem not only has depressed economic growth in Japan, but Japanese bank lending in Asia also is being curtailed. And fourth, it was the Japanese model of strong central government intervention in allocating capital through bank loans that led many of the other Asian nations into what has been called "crony capitalism" or the allocation of loans based more on personal or other relationships rather than on sound market principles. In these ways, Japan has been as much a contributor to the economic problems in Asia as a solution to them.

The Asian financial crisis could hardly have hit Japan at a worse time. Japanese banks that have been struggling for a half decade with an overhang of nonperforming loans at home now face the prospect of many of their foreign loans also turning sour. At the end of 1996, Japanese banks reported total loans outstanding to Indonesia at \$22.0 billion, to South Korea \$24.3 billion, Thailand \$37.5 billion, Malaysia \$8.2 billion, the Philippines \$1.6 billion, and to Taiwan \$2.7 billion. In addition, Japanese banks had loans of \$87.5 billion in Hong Kong and \$58.8 billion in Singapore — both offshore banking centers (which often re-loan the funds to borrowers in other nations) for a total lending exposure in these eight economies of Asia of \$242.6 billion or 62.3% of the total international lending of Japanese banks.⁴¹ Japanese banks have more exposure to the troubled Asian economies than those of any other nation.

Japan has pledged significant amounts as part of the IMF support packages (\$4 billion to Thailand (\$2.68 billion disbursed), \$5 billion to Indonesia (\$1 billion disbursed), and \$10 billion to South Korea. Most of the funds disbursed by Japan are from its Export-Import Bank to finance trade with these countries or through its foreign aid program (which likely would have occurred anyway). The Bank of Japan also has intervened in foreign exchange markets to support certain Asian currencies. The Japanese support is partly under a program agreed upon by the finance ministers of the Group of Seven (G-7) industrialized nations on February 20, 1998 in which Japan's Export-Import Insurance Division of the Ministry of International Trade and Industry (MITI) is to underwrite \$1 billion of trade insurance for each Thailand and Indonesia. Japan's Export-Import Bank also provided about 300 billion yen (\$2.3 billion) in loans during Japan's fiscal year 1997 (ending March 30, 1998) and another \$1 billion this fiscal year in order to promote trade between Japan and the region.

The problem with Japan has been its basic economic policy stance. Until recently, the underlying strategy of the Japanese economic policymakers seems to have been to: (1) increase the surplus in its trade accounts by allowing the yen to weaken, (2) encourage capital outflows, (2) place higher priority on reducing the budget deficit (tight fiscal policy) than stimulating economic growth, (3) pursue a monetary policy that appears to be loose but actually is restrictive in some respects, and (4) take only

⁴¹Bank for International Settlements. *The Maturity, Sectoral and Nationality Distribution of International Bank Lending. Second Half 1996.* Basle, Switzerland, July 1997. P. 19-20.

incremental measures (although sizable) to resolve the problem of nonperforming loans.

Japan's economy is not performing the role as an engine of growth for Asia. Rather the country, itself, is facing recession and has exhibited weak demand for imports from the troubled Asian economies. Over the past year, the only growing sector in the Japanese economy has been net exports. Just when other Asian economies need help, Japan has been relying on its exports, including those to its neighbors in Asia, to generate growth at home.⁴² In February 1998, Japan's surplus on total merchandise trade jumped by 68% from ¥875 billion a year earlier to ¥1,471 billion (about \$11 billion).⁴³ While these surpluses have been declining since the onset of the Asian financial crisis, they are shrinking, not because imports from these countries are increasing, but because Japanese exports there are decreasing. Trade data for January 1998, show that compared with a year earlier, Japanese exports to South Korea declined by 41.8%, to Indonesia by 18.3%, and to Thailand by 34.4%. In the same month, Japanese imports from South Korea did increase slightly, but those from Thailand dropped 5%, and those from Indonesia were down 16%.

Some of this decline in Japan's imports from Thailand and Indonesia can be attributed to the economic turmoil there. Companies in those countries may have had difficulty obtaining trade credits to purchase raw materials or to finance exports. The decline, however, also could be caused by stagnation in the Japanese economy that is depressing imports and a tendency by Japanese firms with subsidiaries in Southeast Asia to favor home production over imports when markets are slack. Exporters in the troubled economies also may bypass the Japanese market in favor of that of the United States and Europe because they perceive Japanese markets to be less open. According to Singaporean trade statistics, for example, Singapore's exports to Japan in December 1997 fell by 7.1% compared with that a year earlier, while exports to the United States rose by 19.8% and to the European Union by 19.7%. At a March 7, 1998, meeting of the Asia Pacific Economic Cooperation (APEC) forum, government and business leaders called on Japan to promote market-opening measures to help alleviate the economic and financial crisis in the region.⁴⁴

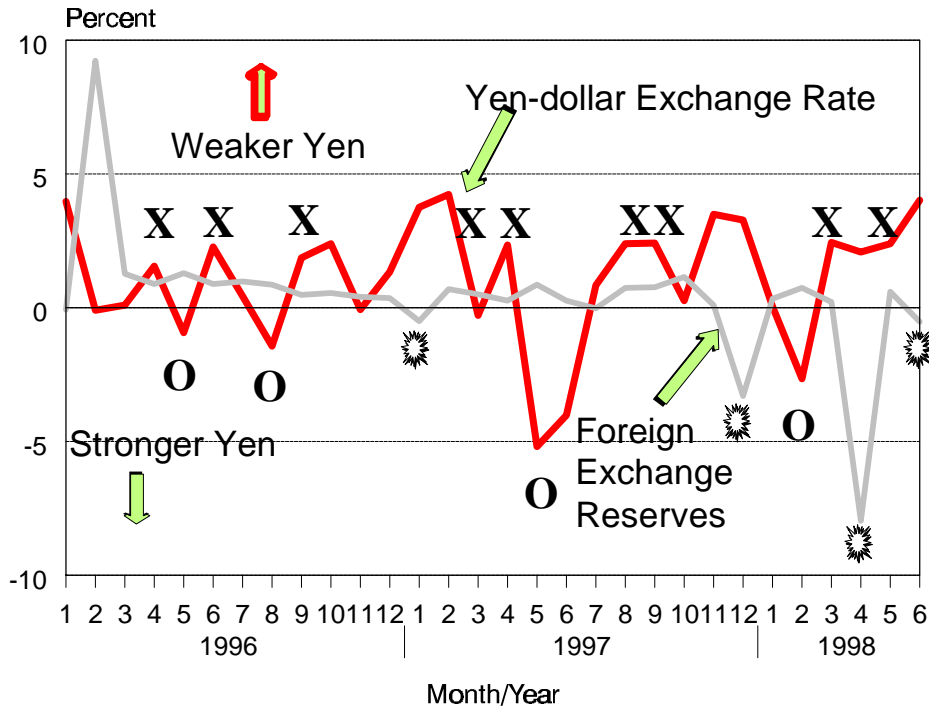
⁴²See, for example, Landers, Peter. *Gaiatsu Galore. Far Eastern Economic Review*, Interactive Edition, March 5, 1998. On Internet at <www.feer.com>.

⁴³Japan. Ministry of Finance.

⁴⁴APEC Officials Urge Japan To Open Market Further. *Nikkei Net News*, March 9, 1998. On Internet at <<http://www.nikkei.co.jp>>.

Figure 11. Monthly Changes in Japan's Yen-Dollar Exchange Rate and Foreign Exchange Reserves (Percent)

(X = Intervention to weaken a weakening yen,
O = Intervention to weaken a strengthening yen,
= Intervention to strengthen a weakening yen.)



Source: Data from International Monetary Fund, Japan Ministry of Finance

Data on holdings of foreign exchange reserves by Japan, moreover, indicate that Japan has been following a deliberate weak-yen policy despite the Asian financial crisis. **Figure 11**, shows monthly percentage changes in Japan's official foreign exchange reserves (including holdings of gold) along with changes in Japan's yen-dollar exchange rate. The accumulation or disposal of foreign exchange reserves is functionally equivalent to intervention in foreign exchange markets. If Japan's central bank is accumulating foreign exchange, it is refraining from converting dollars, marks, pounds, and other foreign currencies into yen. This weakens the value of the yen and strengthens the value of foreign currencies, particularly the dollar. (As the volume of Japan's foreign trade increases, its need for foreign currency reserves also may rise, but the level of Japan's currency reserves seems out of line with those of other major trading nations. Germany's reserves [including gold] are about \$80 billion, the United Kingdom's about \$40 billion, and the U.S. government's about \$70 billion.)

If Japan's policy is to stabilize its exchange rate, changes in its holdings of foreign exchange and in the level of its exchange rate should move in opposite directions. When the yen is weakening, Japan should be selling foreign exchange (buying yen), and vice versa. If, however, Japan is accumulating foreign exchange at the same time that its currency is weakening, it is pursuing a "weak yen" policy. It is intervening in the market to further weaken the yen. In **Figure 11**, such policy episodes predominated during 1996 and 1997. They are indicated by an **X** in the

figure. When Japan is accumulating foreign exchange at a time the yen is strengthening, it also is pursuing a policy of weakening the yen. These episodes are indicated with an **O** and add to the episodes in which Japan pursued a “cheap yen” policy. The times when Japan was selling dollars to strengthen its yen, which is the policy the United States has encouraged Japan to take, are indicated by a **.** These episodes occurred primarily after the onset of the Asian financial crisis (from mid-1997) and primarily after the value of the yen had dropped to levels that threatened to further destabilize world markets. Even during the Asian crisis, however, Japan has, at times, reported net increases in foreign exchange reserves. After intervening in foreign exchange markets by selling off \$1.1 billion in June 1998, the Bank of Japan added \$1.6 billion in July to raise its foreign exchange reserves to \$207.5 billion.⁴⁵

Japanese monetary policy also faces a dilemma. Some economists point out that interest rates have fallen so low (the Bank of Japan’s discount rate is 0.5%) that they no longer provide any stimulus.⁴⁶ Even with cheap loans, businesses report that they face a “credit crunch” because banks are not anxious to lend. One cause of this reported reluctance in the midst of an easy money policy is that Japanese banks are now required to meet international banking standards for their capital-asset ratios. Since banks count part of their unrealized gains on holdings of corporate equities as capital, the decline in values on Japanese stock markets has reduced their capital and forced them to decrease their assets (loans) to keep their ratios from falling below the required level. One suggestion is for Japan to reflate its economy by expanding its money supply and continue to allow its currency to depreciate.⁴⁷ In June 1998, Japan’s money supply ($M_2 + CD$ ’s) was up only about 3.5% from the year previous. Given the need for economic stimulus, this increase seems fairly conservative.

The United States and other industrialized nations have been encouraging Japan to stimulate its economy by cutting taxes, increasing spending, and taking other measures. On April 9, Prime Minister Hashimoto announced a long anticipated economic stimulus package that included a ¥10 trillion yen (about 2% of GDP or \$75 billion) increase in government spending and tax cuts. It was the largest stimulus package in Japanese history, but was greeted with little enthusiasm by investors on Japan’s stock exchange. It includes a ¥4 trillion tax cut that had been advocated by U.S. officials. When Japan’s new Prime Minister Keizo Obuchi took office on July 31, 1998, he promised to temporarily freeze the fiscal austerity law with its limits on the budget deficit, to implement an additional ¥10 trillion supplementary budget, and carry out ¥6 trillion in permanent income tax cuts.⁴⁸ Obuchi’s promised policy changes, however, are yet to be implemented.

⁴⁵Japan’s Exchange Reserves Climbed to \$207.5 Billion in July. *The Daily Japan Digest*, August 6, 1998. P. 2.

⁴⁶Meltzer, Allan. Time for Japan to Print Money. *On the Issues*, American Enterprise Institute for Public Policy Research, August 1998.

⁴⁷*Ibid.*

⁴⁸Obuchi Urges Party Support in Tackling Economy. Kyodo News Service newswire article. August 6, 1998.

In March 1998, U.S. Treasury Secretary Rubin said that one of the keys to Asian recovery is Japan. As the Group of Seven industrialized nations' finance ministers had stated in London, a return of domestic, demand-led growth and confidence in Japan, through pursuit of appropriate policies, could contribute greatly to recovery in Japan's Asian neighbors, and Japan's failure to accomplish these objectives is a major impediment to Asia's recovery.⁴⁹

In August 1998, the IMF announced the results of its annual assessment of Japan's economy. The IMF Executive Directors noted that the performance of the Japanese economy had been much weaker than anticipated. The recent economic downturn as well as the related weakness of the yen were especially worrisome since they had exacerbated economic difficulties elsewhere in Asia and adding to instability in financial markets. They expected growth to be low in 1999 and the downside risks to be considerable. The Directors stressed the need for Japan to take swift and decisive measures to reverse the deteriorating economic situation and place the economy back on a path of sustained domestic demand-led growth. In their view, Japan's overall response so far has fallen short of the timely, comprehensive, and forceful program that is required.⁵⁰

In the 105th Congress, H.R. 3580 (Livingston) expresses the sense of the Congress "that Japan should assume a greater regional leadership role, coinciding with its goal of promoting strong domestic demand-led growth and avoiding a significant increase in its external surplus with the United States and the countries of the Asia-Pacific region."

Conclusion

The Asian financial crisis has put the brakes on the rapid economic growth in many of the so-called "Asian Tiger" economies and threatens to spread further to other regions of the world. After a period of relative stability and some recovery in the first half of 1998, conditions have worsened. The strengthened U.S. dollar is making imports cheaper for Americans and U.S. exports more expensive for Asian and other buyers. Debate continues around the increase in funding and role of the IMF in the financial crisis. In the 105th Congress, the Senate has passed (with conditions) the Clinton Administration's request for the \$17.9 billion increase in the IMF's capital base and borrowing arrangements. This is the major legislative issue now being considered by Congress with respect to the Asian financial turmoil that is becoming global in scope. Regardless of the outcome of the IMF funding legislation, the increased scrutiny and experience of the IMF resulting from the Asian financial crisis already is inducing changes that are making the IMF more transparent, able to respond more quickly to currency and financial crises, and have moved the IMF

⁴⁹U.S. Secretary of the Treasury Rubin. Secretary Robert E. Rubin Remarks Before the Institute of International Bankers. March 2, 1998. On Internet at <<http://www.treas.gov/press/releases/pr2266.htm>>.

⁵⁰International Monetary Fund. IMF Concludes Article IV Consultation with Japan.. Public Information Notice No. 98/60, August 13, 1998. On Internet at < <http://www.imf.org/external/np/sec/pn/1998/PN9860.HTM>>.

toward more involvement in the microeconomic aspects of a borrowing country's economy.

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