

# CRS Report for Congress

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## IMF and World Bank Activities in Russia and Asia: Some Conflicting Perspectives

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## **ABSTRACT**

This report describes the programs the International Monetary Fund (IMF) and World Bank have funded in Russia and Asia in recent years in response to economic crises in these countries. It presents the Bank and Fund's own assessments of their activities. It also relates the views of some prominent critics. The report will not be updated.

# IMF and World Bank Activities in Russia and Asia: Some Conflicting Perspectives

## Summary

Between 1997 and 1999, the International Monetary Fund and World Bank funded major programs to help Russia and the Asian countries counter their economic crises and to promote basic economic reform. During this period, the World Bank lent Russia some \$11.8 billion; it also lent to Korea, Thailand, and Indonesia to help them respond to the Asian financial crisis. In 1997 and 1998, the IMF lent \$37.45 billion (SDR 27.5 billion) to the same three Asian countries. Meanwhile, the IMF lent \$18.2 billion (SDR 13.2 billion) to Russia, of which \$7.7 billion (SDR 5.8 billion) had been disbursed by the time the IMF loan program was cancelled.

The Bank and Fund generated a wealth of material analyzing and explaining their efforts. They claim that their programs in Asia and Russia were quite successful overall. They acknowledge that they encountered unprecedented challenges and they had to learn and adapt their programs in response to changing conditions. They admit that the results sometimes fell short of their original expectations. Nevertheless, the Bank and Fund reject any suggestion that the depth and severity of the Asian and Russian crises were caused by terms and conditions of their programs. Any shortcomings are attributable, they say, to the fact that governments sometimes failed to fulfill their agreements or took steps which made the crises in their countries more intense and difficult than would have otherwise been the case.

Many analysts have been critical of the way the international agencies dealt with the Russian and Asian crises. This report focuses on the views of Joseph Stiglitz, Jeffrey Sachs, and, to a lesser extent, Nicholas Stern and Bruno Pinto. They argue that the IMF put too little emphasis on programs to reform the basic economic institutions and the economic framework in its borrower countries. They claim the international financial institutions (IFIs) have made conditions worse in many of the countries they have sought to help. Often, they argue, the IFIs' original perceptions and predictions are wrong, when they first address an economic crisis, and they prescribe the wrong economic medicine. They maintain that the IFIs should be more accountable for their mistakes. IFI spokesmen respond that most of the comments by the critics are unfunded or based on only a partial understanding of the Russian and Asian contexts. The Bank and Fund maintain that they have incorporated many of the lessons they learned in Russia and Asia into their current programs in these and other countries.

On March 8, 2000, by the International Financial Institutions Advisory Commission released its report discussing future policy towards the IMF and the multilateral banks. The present CRS study was prepared prior to the issuance of that report and does not discuss the Commission's findings.

## Contents

Introduction .....	1
The Crises from the Perspective of the IFIs .....	4
The World Bank in Russia .....	4
The IMF in Russia .....	6
The IMF and the Asian Crisis .....	7
The World Bank and the Asian Crisis .....	10
The Views of Some Prominent Critics .....	14
Critiques of the IFI Programs in Russia .....	14
Critiques of IFI Programs in Asia .....	16
Did the IMF Worsen the Crisis? .....	17
Closing Weak Financial Institutions .....	18
Poor Forecasts .....	19
IMF Accountability .....	19
IMF Not Attuned to Needs of Poor Nations .....	19
Appendix .....	21
Relevant CRS Products .....	21
Articles and Other Published Reports .....	21

## List of Tables

Table 1. World Bank Lending to Three Asian Countries, FY1997-99 .....	11
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# IMF and World Bank Activities in Russia and Asia: Some Conflicting Perspectives

## Introduction<sup>1</sup>

There has been considerable discussion in the past few years about possible changes in the “architecture” of the international financial system. In this context, the term “architecture” refers to the policies and programs of the international financial institutions (IFIs), the relative division of labor among them, the prevailing norms for exchange rate systems and country economic policies, and the way the IFIs relate to the private sector. Many analysts believe that the ways the World Bank and International Monetary Fund (IMF) responded to the recent economic crises in Russia and Asia cast considerable light on these issues. Some argue that the Bank and Fund’s programs in Russia and Asia were deeply flawed. They find evidence justifying major changes in the international agencies’ future operations and policies. Others insist that the Bank and Fund performed creditably in Russia and Asia. They maintain that the record demonstrates the efficacy of the agencies’ work. They also say the record illustrates the problems that international agencies often face when they deal with governments that are reluctant to implement needed reforms.

This report discusses the roles the International Monetary Fund and the World Bank have played during the recent economic and financial crises in Russia and East Asia. It does not purport to be a comprehensive discussion of the issues. Rather, it provides the reader with some conflicting views regarding the efficacy and success of IFI programs in these regions. First, based solely on IFI documents, it presents the Bank and Fund’s description and assessment of their programs in Russia and their responses to the Asia financial crisis. Second, it presents some critiques of the IFIs by several prominent analysts. Joseph Stiglitz was, until recently, Chief Economist at the World Bank, a former Chairman of President Clinton’s Council of Economic Advisors and Professor of Economics at Stanford University. Jeffrey Sachs is Professor of Economics and Director of the Institute for International Development at Harvard University. Nicholas Stern is the new Chief Economist at the World Bank. Brian Pinto is a senior economist at the same international agency. The selection of critics was influenced by Congressional inquiries. The individuals included in this report have not only criticized the performance of the IFIs, but also suggested remedial actions to improve their performance.

A number of CRS studies already address the Russian and Asian crises and the operations or functions of the international financial institutions (IFIs). The present report is a supplement to those reports. A list of relevant CRS products and a chronological list of articles by the IFIs and these critics is provided at the end of this report.

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<sup>1</sup> Prepared by Jonathan E. Sanford, Specialist in International Political Economy.

The first section of this report summarizes the World Bank and IMF's own assessments of their activities – including a description of their programs and *post hoc* evaluations regarding what worked and what did not. Between 1997 and 1999, the international agencies funded major programs to help Russia and the Asian countries counter their economic crises and to promote basic economic reform. They also generated a wealth of material analyzing and explaining their efforts. The Bank and Fund claim that, overall, their programs in Asia and Russia were quite successful. They acknowledge that they encountered unprecedented challenges and they had to learn and adapt their programs in response to changing conditions. They admit that the results sometimes fell short of their original expectations. Nevertheless, they reject any suggestion that the depth and severity of the Asian and Russian crises were caused by terms and conditions of their programs. Any shortcomings are attributable, they say, to the fact that governments sometimes failed to fulfill their agreements or took steps which made the crises in their countries more intense and difficult than otherwise would have been the case.

Stiglitz and Sachs have been sharply critical of the way the international agencies dealt with the Russian and Asian crises. Stiglitz argues that the IMF's programs in Russia and Asia were based on obsolete economic concepts. They put too much emphasis, he says, on the old "Washington Consensus," a package of policy measures adopted in 1991 for Russia and followed by Russian reformers. This emphasized the need for strong macroeconomic measures and policies aimed at promoting liberalization, exchange rate stabilization, and privatization. The IMF should have put more emphasis, he argues, on programs that seek to change the way that enterprises and economic institutions operate.

This approach has come to be called the "Post-Washington Consensus." It underscores the need for change in the basic institutional infrastructure. In particular, it says that countries need to adopt market-oriented reforms in their banking, budgeting, and administrative systems. The goal should be the development of an incentive system based on profit-seeking and competition to replace the old norms that hampered growth and innovation. Unless there is fundamental change in the incentive system, the Post-Washington Consensus insists, the reform programs embodied in the earlier Consensus – liberalization, stabilization, privatization – will be ineffective or perhaps even counterproductive.

Sachs maintains that the IMF failed to take adequate steps to promote successful reform in Russia. Specifically, he says, it failed to prevent crony privatization, corruption, capital flight, and poor donor oversight and it failed to promote growth in the Russian economy. However, Sachs did not call for a change in the Washington Consensus nor did he agree that he may have been mistaken in his support for the so-called "shock therapy" policy earlier in the decade. Shock therapy involves the adoption of macroeconomic policies that seek to achieve rapid stabilization and adjustment of a country's economy.

In Asia, Sachs argues, the IMF made the situation worse in the countries it sought to assist. He says it made the economic crisis in these countries more severe and most of its predictions and initial remedies were wrong. He maintains that the IMF has not been held accountable for its poor performance in Asia. Also, Sachs affirms, the IMF's programs in Asia were influenced too much by the preference of

the United States and other major countries. Developing countries have too little influence, he maintains, over the shape of IMF policy even though they comprise much of the world's population and a substantial majority of the IMF membership.

It is difficult to discern, from the Bank and Fund's analyses of the Russian and Asian crises and their descriptions of their activities in response to those crises, what the two agencies may have learned from their experiences. The Bank and Fund both say their institutions were not at fault and that greater attention should be placed in the future on structural concerns and the strength and stability of national economic institutions. However, their reviews are quite different when they seek to answer the questions: What did we learn? What needs to be changed?

The International Monetary Fund appears to accept the necessity of developing an institutional infrastructure. The current IMF Russian program has a section of structural change jointly crafted with the World Bank. Moreover, the IMF delayed the allocation of the current funding to Russia on grounds that Russia was not making the required structural changes. The IMF has not acknowledged, however, that this was a change of policy nor did they accept responsibility for any past policy mistakes that may have led to poor Russian performance.

The World Bank chief economists Joseph Stiglitz and his successor Nicholas Stern<sup>2</sup> have both been articulate proponents of the Post-Washington Consensus, stressing changes in the institutional infrastructure. Stiglitz continues criticize IMF policy from his position at the World Bank and to articulate the more detailed structural changes he believes are necessary for effective reform. His World Bank colleague, Brian Pinto, has been more specific about the detailed changes needed in the non-payment system impeding sustained growth in Russia.

It is uncertain how the two agencies envision their future interrelationship. During the Asian crisis, the IMF took the lead in negotiating strategies with the borrower countries. Structural reform was the centerpiece of these strategies, yet the World Bank and the Asian Development Bank were responsible for the design and implementation of the projects which sought to effect those structural reforms. The IFIs have not indicated whether they believe the IMF should continue to play the predominant role in future crises, with the multilateral development banks serving mainly to implement parts of the IMF-approved plan. An alternative case might be made, in the light of recent experience, that the MDBs might play a larger role – perhaps even a leading role – in the formulation of plans to deal with future crises in developing countries.

It is worth mentioning that most of the critiques of IFI activity in Russia and Asia have focused on the IMF. The multilateral development banks have come in for relatively little criticism and prescriptions for policy change. Many of the comments about the IMF are criticism of the performance of the recipient countries, on the

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<sup>2</sup> Joseph Stiglitz. "More Instruments and Broader Goals: Moving Toward the Post-Washington Consensus." Helsinki, UNU World Institute for Development Economics Research. WIDER Annual Lectures 2. January 1998. Nicholas Stern, *The Transition in Eastern Europe and the Former Soviet Union: Some Strategic Lessons from the Experience of 25 Countries over Six Years*, EBRD Working Paper #18, April 1997

assumption that the IMF could have promoted better performance if it had managed its operations differently.

It is interesting to note that some of the sharpest criticisms of IMF performance have come from analysts based in sister international agencies. This is unusual. Their principal concerns relate to the development of institutional infrastructure. They believe the IMF should have been more attentive to this aspect of its programs in Russia and Asia. Nevertheless, institutional development seems to be more a developmental than a monetary issue. As such, it would seem to fall within the purview of the multilateral development banks. The MDBs could have moved earlier, before the Russian and Asian crises, to address questions of institutional development. This would seem a natural issue for them to bring to the table when they meet to coordinate plans and programs with the IMF.

The IMF's evident preference for macroeconomic programs focusing on liberalization, stabilization, and privatization would seem consistent with its organizational focus. If institutional issues are not being sufficiently addressed in IMF programs, then perhaps more attention ought to be paid to the mechanisms through which the IMF and the multilateral banks coordinate their operations. Perhaps the leading role that the IMF traditionally plays in framing country programs does not leave sufficient room for other agencies to press consideration of developmental issues such as institutional reform.. Alternatively, the IFIs may have been too attuned to the formulation and implementation of their own programs. In this regard, further improvements might be needed in the ways they coordinate their policy goals and operational plans in individual countries.

## **The Crises from the Perspective of the IFIs<sup>3</sup>**

### **The World Bank in Russia**

Through calendar year 1999, the World Bank approved 44 projects for Russia totaling \$11.82 billion. In addition, it is implementing three projects for \$83 million approved by the Global Environmental Fund (GEF). All of the World Bank's projects in Russia are being financed through its near-market rate loan facility, the International Bank for Reconstruction and Development (IBRD).

The World Bank remarks<sup>4</sup> that Russia has been a difficult place to do development lending. Economic and political instability and an uncertain policy environment complicate the Bank's efforts to identify good projects and to implement them effectively. The Bank says it has been seeking to build a long-term relationship

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<sup>3</sup> Prepared by Jonathan E. Sanford, Specialist in International Political Economy.

<sup>4</sup> The present discussion is based on several World Bank documents, all available from the World Bank web site at [www.worldbank.org]. For the appropriate menu, select "Regions and Countries" and then "Russian Federation." These include "Russian Federation: Country Assistance Strategy–Public Information notice (CPIN)", December 22, 1999; "Russian Federation: Country Assistance Strategy (CAS)–Progress Report, December 1999; "IFC Operations" and the Bank's country brief titled "Russian Federation", August 1999.



with Russia. This suggests that the Bank believes it may need to overlook aspects of the current situation that might otherwise give it pause in other countries.

The Bank's strategy in Russia has several main emphases:

- encourage reductions in the institutional barriers to growth, particularly in areas such as governance, institutional reform, improved effectiveness of public institutions, and better public sector resource management.
- reduce poverty and limit the suffering associated with the current process of transition by encouraging economic growth and strengthening the social safety net.
- maintain or improve the effectiveness of the Bank's existing portfolio of projects.

The Bank says the environment in Russia has been uncertain regarding the future prospects of Bank-funded projects and the realization of the Bank's country strategy. The economic fundamentals remain unstable, corruption and ineffective public institutions hinder implementation, and political instability and changes in leadership have made it difficult for the Bank to pursue its long-term strategy. In particular, the Bank reports, the Duma's rejection of fiscal and institutional changes raises questions about the government's ability to achieve the goals of its reform program.

In the interim, the Bank says it should pursue a more limited agenda which does not appear to require major allocations of resources. This agenda includes:

- continuing efforts to provide advice on policy reform, public resource management, and technical assistance to help strengthen the financial sector.
- emphasizing programs that address social issues and respond to the country's emergency needs.
- implementing the existing portfolio of Bank-funded projects, in order to assure their effectiveness in the face of current difficulties.
- reviewing the policy-based loan programs<sup>5</sup> for Russia that the Bank has already approved, with the possible suspension of future disbursements if Russian compliance with the agreed terms of the loans does not improve.

The World Bank has substantially reduced its levels of lending to Russia. In calendar year 1997, it lent Russia \$3,444 million. In calendar 1998, it lent an additional \$1,900 million. In calendar 1999, by contrast, the Bank approved two technical reform projects totaling \$60 million. Most of the Bank's loans to Russia in recent years (\$3,700 million of the total approved in 1997 and 1998, for instance) have been policy-based loans. A substantial portion of the funds associated with these loans has not been disbursed as yet because of compliance problems.

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<sup>5</sup> Policy-based loans are loans that require the borrower to effect specified changes in economic policy or operational procedures before the proceeds of the loan may be disbursed.

## The IMF in Russia

In 1997 and 1998, the International Monetary Fund agreed to loan Russia SDR 13.2 billion (\$18.2 billion.) Of this amount, SDR 7.4 billion (\$10.46 billion) had not yet been disbursed when the IMF cancelled its Russian loan program in 1998. The IMF says that the goals of its program in Russia have been achieved or exceeded. Any failures or shortcomings in its program were not the fault of the IMF, the Fund's spokesmen argue, but were caused by insufficient or inadequate Russian compliance with the terms of its IMF-approved economic reform program.

Michel Camdessus, the Managing Director of the IMF, reported to the IMF Executive Board in December 1999<sup>6</sup> that important progress had been made in Russia in the implementation of its macroeconomic program. Program expectations had been exceeded, he said, regarding economic growth, the containment of inflation, the fiscal balance, and international reserves. He said there had also been some progress realized on the structural side. He noted that a number of the structural benchmarks set for the end of September 1999 had not yet been met, but he implied that he believed these would be met in the near future.

In a newspaper commentary<sup>7</sup> published in September 1999, Camdessus explained the IMF's relationship with Russia. He said that "engagement is better than isolation" when it comes to major countries experiencing serious economic difficulties. He said there is "reason to hope that economic reform will succeed in Russia" and other countries making the transition from communism. However, he also said the "transition from the black hole of the Soviet command economy will take years, and progress will not be linear" and "any achievements will fade into impossibilities if we walk away from Russia." The loss of confidence and inward turning that would come from our abandonment of the Russian people, he said, "are in the interests neither of Russia or the rest of the world."

The previous month, John Odling-Smee, Director of the office responsible for IMF operations in Russia, wrote an article<sup>8</sup> explaining the Fund's decision to resume lending to Russia in July 1999. Russia has made major progress since 1992, he said, moving from a centrally-planned to a market-oriented economy. It has been a reform effort whose scale and ambition have few parallels and whose outcome is of vital importance to the people of Russia and the rest of the world. The Fund's resumption in lending is justified, he maintains. Important progress has been made and the IMF needs to support Russia's most recent economic policies.

In terms of what is at stake, Odling-Smee says, the relationship between the IMF and Russia is of vital importance. It has been marked by successes and

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<sup>6</sup> "IMF's Camdessus Reviews Status of Russian Programs," IMF News Brief No. 99/81, December 7, 1999. Copy obtained from the IMF web site, [www.imf.org].

<sup>7</sup> Michel Camdessus, "Russia: Long Climb Out of a Black Hole," *The Washington Post*, September 13, 1999. Copy obtained from the IMF web site. Select "country information" and then "Russian Federation."

<sup>8</sup> John Odling-Smee. "Russia's current economic policies are deserving of IMF support." *IMF Survey* 28:17 (August 30, 1999), pp. 273-4. Available from the IMF web site.

disappointments. The IMF understands the complexity of the transition process, he argues, where the economic and political dimensions are intertwined. Most observers have made the same errors that the IMF is being accused by its critics of having made. “If the economic programs the IMF has supported in recent years had been *fully* implemented, Odling-Smee says, “the Russian economy would look very different today.” Maintenance of a continual dialogue between the Russian Government and the IMF is crucial – and the prospects for economic reform are greatest – in those areas where departure from agreed-upon policies can halt IMF lending. In the future, he says, the IMF membership will require greater implementation of programs before funds are disbursed.

Looking at specific issues, Odling-Smee found there is no evidence to support the charge that IMF funds had been stolen or diverted to improper uses. (Other IMF officials have noted, however, that the Russian authorities lied to them about the FIMACO case.) Capital flight is a major problem in Russia, Odling-Smee acknowledged, but he said it is not caused by IMF policies. Rather, it is caused by the lack of implementation by the Russian Government of the programs the IMF loans sought to support.

## **The IMF and the Asian Crisis**

The Fund says that the Asian financial crisis of 1997-9 was unusual. It said, in a 1998 report,<sup>9</sup> that the crisis was “structural” in origin. Unlike most countries that come to the IMF suffering from balance of payments and currency crises, the Asian countries had had relatively strong macroeconomic fundamentals beforehand and (except for Thailand) no real balance of payments problems. The crisis was preceded by a surge of capital inflows which the Asian countries handled poorly. Their banking and finance systems were fragile, weakened by imprudent practices and inadequate regulatory systems, and, the IMF reported, foreign lenders often provided money “without due regard” for the structural weaknesses of the countries’ financial systems. The “combination of a weak banking system and an open capital account” in these countries was, the IMF concluded, “an accident waiting to happen.”

In August 1997, the IMF agreed to lend Thailand SDR 2.9 billion (\$3.9 billion.) The following December, it agreed to lend SDR 15.5 billion (\$20.9 billion) to Korea. The IMF had more difficulty with its program for Indonesia. In November 1997, the IMF approved a loan of SDR 7.338 billion (\$9.9 billion); of this amount, SDR 4.7 billion (\$6.57 billion) had been drawn by August 1998. The IMF then cancelled the original loan to Indonesia and replaced it with an SDR 5.4 billion (\$7.6 billion) loan from its Extended Fund Facility, which is repayable over a longer period of time.

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<sup>9</sup> *IMF. International Capital Markets, 1998.* Chapter III. “Emerging Markets in the New International Financial System: Implications of the Asian Crisis,” pp. 59-81, especially 78-9. Available from IMF web site . The report examined the crisis in detail. It also identified a number of areas where further action might be helpful. These include: better bankruptcy laws, better coordination by countries of their financial regulation and exchange rate policies, improvements in countries’ regulatory environment and reporting procedures, limits on foreign borrowing by banks and nonbank entities, and reductions in the financial “safety net” so that more of the risk from private international financial transactions is borne by the parties involved.

In 1999, the IMF released an assessment<sup>10</sup> of its response to the Asian crisis. The report says that the immediate problem in Asia was a liquidity crisis which led to a rapid decline in currency values. The larger problem, however, was the weakness of their financial institutions and negligent regulatory environments that exacerbated the problem. Large financing packages were also arranged to restore market confidence. Tight monetary and interest rate policies were prescribed to staunch the outflow of capital and stabilize currency values. Budget cuts were prescribed to help support the external adjustment process and to allow room in national budgets for non-inflationary expenditures aimed at restructuring the banking system. However, the study reports, the centerpiece of the IMF strategy in Asia was a broad long-term program of fundamental reform of the countries' economic and policy institutions. These sought to address the root causes of the crisis, improve market confidence, and set the stage for a resumption of growth.

When the Asian programs were being formulated, the study reports, the underlying causes of the economic crisis were less evident than they are now, with the benefit of hindsight. The IMF's initial programs in Thailand, Korea, and Indonesia did not succeed in restoring confidence or lessening the outflow of capital. The report finds that the task was complicated by the limited state of the countries' reserves, by market volatility, and by the array of structural problems. It was also hampered by hesitant program implementation, political uncertainties, and other factors that cast doubt on the authorities' commitment to the program. Other complications included revelations of market-sensitive information, uncertainty about the financial packages, and the difficulty making needed arrangements for government guarantees.

The IMF believed initially that the Asian crisis would have only a modest impact on the countries' rate of growth. The interest and credit policies of the IMF programs sought to prevent a destructive inflation/depreciation spiral from occurring, rather than seeking to stabilize exchange rates at any particular level. The IMF study says that monetary policy in Korea and Thailand tightened as planned and, by the following summer, interest rates had returned to their prior levels and half the depreciation in exchange rates had been reversed. "This is not to deny, of course," the study observes, "that monetary tightening had a cost for the real economy, but the alternative would have been more costly."

In Indonesia, by contrast, monetary policy was not tightened as planned and the recovery stumbled. The IMF study reports that the Indonesian authorities lost control of money and credit, the banking system collapsed, the money supply expanded, and the underlying real interest rates remained negative while nominal interest and exchange rates bore major market risk premiums.

Fiscal policy in the three countries was also based on an assumption that the slowdown in growth would be modest. The IMF analysts say that, if the fiscal policies prescribed in the original programs had been implemented as planned,

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<sup>10</sup> See: Timothy Lane, *et al.* *IMF-Supported Programs in Indonesia, Korea, and Thailand: A Preliminary Assessment*. IMF Occasional Paper 178. International Monetary Fund, 1999, 82p. See also another study that focuses specifically on the financial sector. Tomás J.T. Baliño, *et al.* *Financial Sector Crisis and Restructuring: Lessons from Asia*. International Monetary Fund, 1999, 80p. Both are available from the IMF web site.

economic growth in the three countries would have declined quite substantially. However, they report, fiscal policy in the countries relaxed in 1998 as the recession deepened and current account surpluses emerged. Governments made room in their budgets, even to the point of deficit financing, in order to assure funding for social safety-net programs and to accommodate spending for programs (the “automatic stabilizers”) designed to stimulate spending and slow the contraction of the economy. Unfortunately, the study indicates, Korea and Indonesia were unable to increase their spending rapidly enough to have the desired stimulative effect.

The study indicates that the Fund failed to anticipate the severity of the downturn in the borrower countries. The steps taken by the IMF-approved programs were both too severe and also insufficient to meet the requirements of the crisis. This hurt the credibility of the programs and limited their effectiveness. Still, at the time, the analysts report, few people foresaw the severity of the economic downturn in the Asian countries. In hindsight, they say, it is clear that the IMF should have supported fiscal policies that were less restrictive and monetary policies that sought to accommodate faster growth. It was not so clear at the time, however, the analysts report, that these would be the appropriate measures.

The IMF study says that the programs it supported in Asia did not have enough funding to be successful in an environment where the crucial effort to restore confidence had failed. The decision to float the countries’ exchange rates led to a period of continuous market depreciation. However, IMF analysts maintain, there was no practical alternative – especially in Korea and Thailand – after the governments’ efforts to defend specific exchange rates had exhausted their reserves. The IMF analysts believe the Asian countries might have avoided any need for floating their currencies if their foreign exchange reserves had been larger and they had enjoyed more market confidence. Still, they report, the Asian countries would have had to adopt interest rates that were “punishingly” tight if they wanted to keep the value of their currencies at specified rates. Furthermore, there was no guarantee that this strategy would have enabled them to weather the pressure for devaluation. As it was, the analysts conclude in their 1999 report, the reluctance of the governments to tighten monetary policy in the early stages of the crisis made the later task of stabilizing the value of their national currencies much more difficult.

Stanley Fischer, Deputy Managing Director of the IMF, argues<sup>11</sup> that in recent years the IMF has been playing increasingly the role of lender of last resort. It has also been the crisis leader, negotiating with the countries in crisis and mobilizing international support for financing packages backed by many countries and multilateral agencies. The international financial system needs fundamental reform, he says. Many factors may shape a country’s choice of exchange rate regimes. Both countries with flexible and countries with fixed rate systems have run into trouble. “Nevertheless,” he observes, “it is striking that the major external crises of the last two years – in Thailand, Korea, Indonesia, and Russia – have affected countries with more or less pegged exchange rates.” Fischer argues that economic behavior in those

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<sup>11</sup> Stanley Fischer. “On the Need for an International Lender of Last Resort.” Paper prepared for delivery to a joint session of the American Economic Association and American Finance Association, New York, January 3, 1999. Available from the IMF web site.

countries was profoundly affected by the assumption that their pegged exchange rates would remain stable. This presumption encouraged practices, he says, especially in the banking system, that contribute to the severity of the economic crisis that is likely to follow when they are forced to devalue their currencies.

In 1998, Kunio Saito, director of the IMF office responsible for Asian programs, summarized on one page the nature of the Asian crisis and the IMF's response to it.<sup>12</sup> The crisis was caused, he said, by excessive investment financed by excessive short term borrowing, economic overheating, delays in policy adjustment, and other structural factors such as a prolonged dollar peg. It was characterized by a sudden loss of confidence in exchange markets and the banking system, unprecedentedly large pressures on markets, and rapid and excessive contagion to other countries. In response, he said, the IMF mobilized unprecedentedly large financing packages and processed them within a 2-to-3 week period. It also supported major stabilization and reform programs that required countries to adopt sound macroeconomic policies, to restructure the financial sector, to improve corporate governance, and to adopt other reform measures.

## **The World Bank and the Asian Crisis**

The World Bank and IMF have worked closely in response to the challenges posed by the Asian financial crisis, Sven Sandström, Managing Director of the World Bank, told a conference in 1998,<sup>13</sup> though they have tackled the problem in different ways. The Bank has focused on structural and sectoral issues, he said, while the Fund has focused on macroeconomic aggregates. The Bank has focused on long-term issues, though he said the short-term clearly matters. Finally, he said, the Bank has focused on a broad array of developmental issues facing the Asian countries, not just on economic and financial issues. The Asian crisis threatened to undercut the remarkable record of economic growth that Asia had achieved in recent decades and to throw back into poverty huge numbers of people who had recently escaped that condition. The Bank's core mandate is poverty reduction, Sandström argued. Therefore, it needed to be actively involved in the international effort to restore confidence and growth in order to prevent a serious resurgence of poverty in the region.

The World Bank says the Asian crisis brought to the fore some of the structural and institutional challenges posed by globalization. It also revealed unexpected weaknesses in the financial and corporate sectors in the Asian countries that required correction. The Bank says, in its 1999 annual report,<sup>14</sup> that its operations in the crisis countries have focused in four areas: (1) reshaping the microeconomic environment

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<sup>12</sup> Seminar on ASEAN Financial Policy and Macroeconomic Management. "The Asian Financial Crisis and the IMF." Summary of Presentation by Kunio Saito, March 24, 1998. Available from IMF web site .

<sup>13</sup> Sven Sandström. "The East Asia Crisis and the Role of the World Bank." Statement to the Bretton Woods Committee, February 13, 1998. He is the second ranking official at the World Bank. Available from the Bank web site.

<sup>14</sup> World Bank. *Annual Report, 1999*. Washington, D.C., 1999. "East Asia and the Pacific," pp. 42-53. Text also available from World Bank web site.

in these countries and restructuring their financial and corporate institutions, (2) improving the accountability, transparency, and effectiveness of their official institutions and minimizing corruption, (3) supporting social sectors programs and the emergency safety-net, and (4) safeguarding the environment.

**Table 1. World Bank Lending to Three Asian Countries, FY1997-99**  
(millions of U.S. dollars)

	<u>1997</u>	<u>1998</u>	<u>1999</u>
Korea	0.0	5,000.0	2,048.0
Indonesia	914.5	703.0	2,741.0
Thailand	488.4	380.0	1,300.0
<i>Total</i>	<i>1,402.9</i>	<i>6,083.0</i>	<i>6,089.0</i>

During the past three years, the World Bank has reshaped and expanded its volume of assistance to the countries in Asia suffering most acutely from the financial crisis. During its fiscal year<sup>15</sup> 1997, the Bank's total loan commitments for the three Asian countries totaled \$1,403 million. (See Table 1.) Korea had ceased being a borrower in 1994, and it had subsequently joined the Organization for Economic Cooperation and Development (OECD), a body composed of advanced industrial countries and their peers. In Thailand, two-thirds of the Bank's loans in 1997 went to fund improvements in the country's electric power distribution system, while the remainder supported improvements in the Thai system of higher education in the areas of science and engineering. In Indonesia, except for a \$105 million loan to improve railway efficiency, all the loans approved in 1997 were for educational programs or for regional or village-level development projects.

The focus of the Bank's programs in these three countries was fundamentally different during the next two years. In 1998, Korea received a \$2 billion structural adjustment loan (SAL) and a \$3 billion project loan to help restructure its economy. It received a second \$2 billion SAL in 1999, plus a \$48 million loan to facilitate Korea's plans to restructure its financial and corporate sectors.

The two SALs put money in the Korean central bank in order to help it manage its balance of payments problems. At the same time, they required the Korean government to undertake a wide range of economic policy reforms, as already specified in the letters of intent and other agreements associated with the IMF loan. The IMF disbursed most of the proceeds from its SDR 15.5 billion (\$20.9 billion) loan to Korea up front, to deal with the immediate crisis.<sup>16</sup> Subsequent disbursements from the two World Bank SALs provided resources to help facilitate and encourage further Korean compliance with the reform and stabilization plan. The \$3 billion economic

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<sup>15</sup> The World Bank's fiscal year runs July 1 through June 30.

<sup>16</sup> By May 1998, only SDR 2.9 billion (\$3.9 billion) of the IMF loan money remained undisbursed. The undisbursed balance shrank to SDR 1.3 billion (\$1.8 billion) by April 1999.

restructuring project<sup>17</sup> included measures to restructure the Korean banking and finance sector, reform corporate governance, promote competition and transparency, strengthen needed regulatory procedures, enhance labor mobility, and develop social safety nets to protect the poor.

In Thailand, the Bank also shifted from development projects to economic reform. In 1998, its principal emphasis was a \$350 million loan to finance the restructuring of Thai financial institutions. It also approved two \$15 million loans to facilitate implementation of the restructuring program and improve economic management. In 1999, the Bank approved two loans totaling \$1 billion which aimed to help the Thai authorities restructure the financial corporate sectors still further, improve accountability and transparency, strengthen regulatory procedures, improve the social safety net, and stimulate increased spending on social programs in order to stimulate economic growth. A similar \$600 million loan is planned for 2000.<sup>18</sup> The World Bank also approved a \$300 million loan for Thailand in 1999 to help fund emergency employment programs and assure the continued availability and expansion of essential social service programs.

In Indonesia during 1998, because of uncertainties about the political situation and the government's degree of commitment to fundamental reform, the World Bank focused most of its lending on the types of development projects it had sponsored in the past. In fiscal 1998, it approved loans totaling \$496 million for regional development projects and regional roads and \$146 million for education or social projects. A December 1997 loan of \$20 million was the only loan that year that was clearly directly towards the broader issue of reform. The Bank focused additional resources that year, however, on social concerns. Roughly \$300 million in previously approved funds were reprogrammed for immediate disbursement on social safety-net activities – particularly labor-intensive employment programs and health and education services benefitting the poor.

In fiscal 1999, the Bank found that the Indonesian government's attitude towards reform was more encouraging. In July 1998, it approved a structural adjustment loan which promised to disburse \$1 billion in balance-of-payments support as soon as the government demonstrated that it had taken specified steps in four areas: (1) increasing increase the efficiency and transparency of its public sector operations, (2) reforming the financial sector and laying the groundwork for a future restructuring of corporate debt, (3) implementing a range of structural and policy reforms aimed at improving governance, productivity, and environmental sustainability, and (4) taking actions to protect the poor and continuing investments in education and health. The Bank determined, soon after loan approval, that the government had complied with the conditions and it disbursed the full sum of the loan. The Bank also approved a \$100 million urban renewal project and several projects totaling \$170 million for social safety-net activities in the health and education sectors.

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<sup>17</sup> "World Bank Approves Economic Reconstruction Loan to Korea." World Bank news release 98/1597/EAP, December 23, 1997. Available from the Bank web site.

<sup>18</sup> World Bank. Project Information Documents for Thailand-Economic and Financial Adjustment Loans II and III, pid th58536 and th66068. Available from the Bank web site.



In May 1999, the Bank approved three additional loans, totaling \$1.4 billion, to support additional policy reform activities. Like the \$1 billion policy reform loan approved earlier, the proceeds from the loans were to be used for balance of payments support. The funds would be disbursed, however, only after the government adopted certain specified reforms. The \$500 million policy reform loan required the government to take steps towards further improvements in its fiscal and monetary policies. It identified several major initiatives – particularly the resolution of bad loans, the consolidation or closure of unsound banks, and changes in the rules on corporate governance and investment – that were needed in the banking and corporate sectors. It specified particular steps needed to improve governance and the transparency and efficiency of public and private sector organizations. It also identified particular actions necessary to improve environmental policy and its implementation. The Bank determined, soon after the second policy reform loan was approved, that the government had complied with the specified conditions and it disbursed the balance of the loan.

The two other policy reform loans approved in May 1999 have not yet been fully disbursed. The \$600 million committed for the Social Safety Net Adjustment Loan would be available (as balance of payments support) when the government demonstrated that it had budgeted an adequate amount for social and safety-net programs, when it demonstrated that it had adopted procedures to assure effective implementation of those programs, and when it had created a system of monitoring and control sufficient to safeguard the programs from delay, leakage, and corruption. In February 2000, the World Bank determined that the Indonesian government had made sufficient progress in these areas to merit disbursement of the first half of the funds.<sup>19</sup>

Similarly, the \$300 million Water Sector Adjustment Loan seeks to improve the national institutional framework for water resources development and management. It aims in particular to improve the policies and procedures for river basin management and irrigation. Among other things, it requires that more authority be transferred to autonomous farmer organizations. A small portion of the proceeds of the loan was disbursed upon approval. In February 2000, World Bank officials believed that enough of the specified reforms may have been adopted to justify disbursement of the second tranche, comprising a major share of the proceeds, in the near future.<sup>20</sup>

In sum, the World Bank says of its activities during the Asian financial crisis, that it is helping build a new East Asia. It will be a region, the Bank says, with stronger financial institutions, stronger companies, and increased openness, not only in trade and finance, but also increasing in information and even, it suggests, in politics.

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<sup>19</sup> World Bank. Project Information Documents for Indonesia–Social Safety Net Adjustment Loan, pid id63939. Interview with World Bank official. Available from the Bank web site.

<sup>20</sup> World Bank. Project Information Documents for Indonesia–Water Sector Adjustment Loan, pid id62715. Interview with World Bank official. Available from the Bank web site.

## The Views of Some Prominent Critics

As the Asian financial crisis spread to other parts of the world and as the Russian financial crisis of August 1999 led to default and the collapse of the ruble, many analysts voiced sharp criticism of the appropriateness and effectiveness of the IFIs policies promoting Asian and Russian reform. Prominent among these are Joseph Stiglitz of the World Bank and Jeffrey Sachs of Harvard's Institute for International Development. Their views and the views of several colleagues are summarized below.

### Critiques of the IFI Programs in Russia<sup>21</sup>

Stiglitz's criticism focused<sup>22</sup> on the policy differences between the Washington Consensus and the Post-Washington Consensus. The latter policy accepted the importance of the key macro economic pillars of the Washington Consensus such as liberalization, stabilization and privatization, but called for priority changes at the enterprise level and in economic institutions. Both Stiglitz and Sachs faulted the IMF for failures in Russian reform resulting from Moscow following the Washington Consensus policy adopted by the IMF in 1991.

Stiglitz is a leading architect of the Post-Washington Consensus policy. Sachs consistently held the international financial institution responsible for failures he perceived in Russian reform. The present discussion and the attached chronology highlight the recent criticisms by Stiglitz and Sachs of the IMF in Russia and note the public responses by officials in the IMF, the U.S. Treasury, and the World Bank to the criticisms of IMF/Russian reform policy and performance.

Stiglitz described and criticized the Washington Consensus followed by the IMF in the following statement: "the dictums of liberalization, stabilization and privatization...were evidently not enough. An economy needs an institutional infrastructure."<sup>23</sup> By highlighting institutional infrastructure, Stiglitz emphasized developing "market-friendly" institutions, such as performing private commercial banks and efficient enterprises. Growth in Gross Domestic Product from more comprehensive reform was not enough. Successful reform also required enhancement in the quality of life. To attain this performance, Stiglitz called for reform to "promote democratic, equitable, and sustainable development."<sup>24</sup>

Sachs's critique of the IMF Russian program focused mainly on reform failures without calling for the specific policy changes recommended by Stiglitz. Sachs listed five failures in Russian reforms: crony privatization, official corruption, flight capital, poor donor oversight, and lack of structural change, and he held the IMF largely

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<sup>21</sup> Prepared by John P. Hardt, Senior Specialist in Post Soviet Economics.

<sup>22</sup> Stiglitz, *op. cit.*, footnote 2.

<sup>23</sup> Joseph Stiglitz. World Bank Newsletter, TRANSITION, December 1998.

<sup>24</sup> Stiglitz, "Democratic Development as the Fruits of Labor, January 2000."

responsible for these failures.<sup>25</sup> However, some observers contend that Sachs's prescriptions for Russian reform from 1991 to 1998 were very much in line with the IMF and the Washington Consensus. Although Sachs welcomed the Post-Washington Consensus as articulated by Stiglitz, he viewed success in Poland and Slovenia and failure in Russia as more heavily influenced by geography, (i.e. proximity to the European Union) than the history of pluralism or authoritarianism for countries in transition.<sup>26</sup>

Responses to Stiglitz's and Sachs's criticisms of IMF Russian policy were made by key officials in the IMF, Treasury and the World Bank, such as Stanley Fischer, Lawrence Summers, and James Wolfenson. These official rejoinders did not criticize the Post-Washington Consensus but questioned the critical interpretation of IMF responsibility and culpability for Russian reform failures. They say that everyone had gone through a learning process.<sup>27</sup> Implementation of the IMF programs was limited by what was politically possible.<sup>28</sup> James Wolfenson, World Bank President, criticized Stiglitz for his public criticism of a sister agency and also allowed that it was easier to have 20-20 hindsight. It was announced that Stiglitz would leave the World Bank on January 1, 2000 before expiration of his term in office.<sup>29</sup> However, he did not leave and his office at the World Bank reported on January 18 that he would be staying on for another six months as Special Advisor to the President of the World Bank.

Up to the August 1998 crisis, the IMF had not publicly accepted the Post-Washington Consensus.<sup>30</sup> The Post-Washington Consensus was largely adopted in the current IMF Russian program of July 1999 in the "Structural Reform" section, jointly drafted by the IMF and the World Bank. Some observers suggest that an agreement of the IMF and its critics on the adoption of the Post-Washington Consensus policy may be a step forward, but is still not sufficient for successful reform. These critics believe that a missing piece in the critique may be administrative and military reform. From their perspective, the bloated and counter-productive civilian bureaucracy and military forces foster corruption and impede efficient transition.<sup>31</sup>

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<sup>25</sup> Sachs, "Calling the IMF to Account," op. ed., the *New York Times*, September 8, 1999.

<sup>26</sup> Sachs, "Eastern European Reforms: Why the Outcomes Differ So Sharply," *Boston Globe*, September 17, 1999.

<sup>27</sup> Fischer, "What Went Wrong in Russian Reform?" *Financial Times*, September 17, 1999.

<sup>28</sup> Summers, Testimony to House Banking Committee on Russia, September 1999.

<sup>29</sup> World Bank Economist Felt He Had to Silence Criticism or Quit," the *New York Times*; December 2, 1999

<sup>30</sup> The IMF led Russian Assistance Program," featuring Stanley Fisher and Aleksei Mozhin of the IMF on a panel of the Heritage Foundation, July 23, 1998.

<sup>31</sup> Brian Pinto, "The Russian Federation, Dismantling Russia's Non-payment System Creating Conditions for Growth." World Bank, September 1999. For commentary, see *Financial Times*, February 2000.

The World Bank has been more specific in their diagnosis of the poor Russian economic performance and their prescriptions for remedial change in developing an institutional infrastructure. The critical problem the World Bank addresses is that of breaking up the non-payment system in Russia.<sup>32</sup> Without an efficient tax code, a working banking system and a bureaucratic system that regulates enterprises, Russia will not be able to gather taxes, manage debt, pay wages and pensions and otherwise make the system solvent. These changes would positively influence the Russian economic incentive system. The present system is viewed as persistently undermining economic growth.

### **Critiques of IFI Programs in Asia<sup>33</sup>**

Jeffrey Sachs is a Harvard University professor and Director of the Harvard Institute for International Development. He also was a member of the International Financial Institution Advisory Commission which issued its report on March 8, 2000.<sup>34</sup>

The Sachs criticism of the IMF seems to arise partly from his background as Director of the Harvard University Institute for International Development (which is to be closed ) and partly from his work advising governments of former communist states in transition – such as Poland, Slovenia, and Russia. The Harvard Institute focuses on alleviating poverty in developing countries, while Dr. Sachs has advised transitional economies to adopt economic policies that include privatizing industries and maintaining flexible exchange rate regimes. Sachs also plays the role of the independent professorial advisor who can advocate policies without coping with the difficulties of changing bureaucratic inertia or actually implementing them. He has long criticized IMF programs in various countries and the way that the IMF operates. The policies he advocates, generally stem from principles of free markets, privatization, debt restructuring/relief, and transparency in IMF operations, although he also appears sympathetic to the East Asian reliance on state-led industrialization.

With respect to the role and operations of the IMF in the Asian financial crisis, Sachs has made the following statements:

- The IMF deepened the sense of panic in Thailand, Indonesia, and South Korea by undermining foreign investor and lender confidence by its dire public pronouncements and proposed austerity programs. The IMF's approach to Asia was patterned after its approach to problems in Latin America and elsewhere – a focus on restraining government spending and raising interest rates to stabilize currency values rather than on containing private-sector financial panic.

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<sup>32</sup> *Ibid.*

<sup>33</sup> Prepared by Dick K. Nanto, Specialist in Industry and Trade.

<sup>34</sup> International Financial Institution Advisory Commission. *Report of the International Financial Institution Advisory Commission*. March 8, 2000. 124 p.

- The IMF insistence on closing weak financial institutions and tightening regulatory standards worsened the crisis by drying up lending in Thailand, South Korea, and Indonesia.<sup>35</sup>
- Almost every IMF prediction about the Asian financial crisis and its own “bailout” programs has been proven wrong.
- The IMF is not being held accountable for its actions, its failed forecasts, and the details of the “advice” it imposes on the developing world.
- IMF program documents are not open to public debate and critical scrutiny.
- The IMF is dominated by the United States, European Union, and Japan. Developing countries have little influence in IMF decision making despite their large populations.<sup>36</sup>

Sachs’ criticisms of the IMF appear to have some validity and have been heard from other quarters also. Some of them have been bolstered by benefit of hindsight, but others were made during the crisis and before the negative effects of the IMF prescriptions were felt in the countries in question. The IMF has been reviewing its own programs as well as responding to criticisms from Sachs and others. It has modified its operating methods and pursued policies oriented toward alleviating poverty in addition to their traditional purpose of stabilizing exchange rates.

**Did the IMF Worsen the Crisis?** The core of Sachs’ criticism is that the IMF worsened the Asian financial crisis rather than easing it by its dire public pronouncements and the fiscal austerity and high interest rate policies (tight monetary and fiscal policies) it required of borrowing countries as a condition for loans. Sachs views the Asian financial crisis as being caused more by investor/lender panic than structural financial problems and governmental economic policies. For him, the solution should have been more to stop the panic rather than to perform major surgery on frail economic systems. He admits that the Asian countries had allowed themselves to become too dependent on short-term borrowing in foreign currencies for long-term domestic projects and had maintained their exchange rates fixed at excessively high values despite clear market signals that devaluation would have been prudent. He points out, however, that just months before the onset of the financial turmoil, the IMF and other organizations were praising the economic performance (growth rates) of the very Asian nations hit by the crisis. According to Sachs, since the short-term borrowing was private, the solution should have been to work out a deal with private foreign creditors in order to stem the panic and to provide some short-term liquidity, rather than for the IMF to rely on high interest rates and fiscal austerity to try to keep capital from fleeing the countries in question. The high interest rates, in particular, plunged the economies into deep recession.

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<sup>35</sup> Sachs, Jeffrey. Fixing the IMF Remedy. *Banker*, v. 148. February 1998. Pp. 16-18.

<sup>36</sup> Sachs, Jeffrey. The IMF and the Asian Flu. *The American Prospect*, March-April 1998. P. 16-21.

The IMF maintains, however, that the high interest rates were a short-term emergency measure. The rates came down as the economies were stabilized. In South Korea and somewhat less so in Thailand, the recessions were relatively short-lived, given the severity of the initial crises. According to most observers, the political turmoil in Indonesia that accompanied the financial crisis made a return to normalcy nearly impossible – regardless of what the IMF did or did not do. Much of the capital flight (converting liquid assets into foreign currency), moreover, was by investors in stock markets and by local wealth-holders who were trying to protect their wealth by converting assets into dollars as their home currency values plummeted. Reassuring these investors would have been a much more formidable task than gathering a small number of creditor bankers in New York to discuss rolling over their loans. In other words, Sachs may have a good point, but in the midst of a financial panic, working out a deal with enough private foreign creditors and investors to stem the capital flight would have been extremely difficult or impossible.

At any rate, the IMF appears to have been affected by its experience in the Asian financial panic and is taking more preventive measures to try to keep panics from occurring. The IMF also shares the conclusion of many observers that the “efficient operation of the international system requires more private sector involvement in the prevention and resolution of financial crises.”<sup>37</sup> In other words, the IMF feels that foreign banks and other lenders (rather than investors and local citizens) need to bear more of the costs of financial crises.

The IMF maintains, moreover, that the monetary and fiscal restraints on the countries in crisis were eased as economies stabilized or dropped into recession and regulations were revised as appropriate. The IMF also states that it recognizes that macroeconomic stability alone cannot solve financial crises. During most of its existence, the IMF has focused on “first-generation reforms” intended to make markets work more efficiently to ensure stability. These included reforms in pricing, exchange rates, taxes, and government expenditures and by establishing rudimentary market institutions. These actions proved particularly important for Eastern European countries as they dropped their failing systems based on central planning and control. The IMF now recognizes that financial stability also relies on “second-generation reforms,” that is, reforms and institution-building that is needed for a country to attain sustained, high-quality growth. The scope of these reforms is now being defined and would include sound economic, social, and political institutions.<sup>38</sup>

**Closing Weak Financial Institutions.** Sachs also criticizes the IMF for insisting that weak financial institutions be closed and their regulatory standards be tightened. He claims that this worsened the crisis by drying up lending. Lending activity by banks and other financial institutions certainly did drop and, for a time, dried up during the financial crises in Thailand, South Korea, and Indonesia. The Sachs criticism, however, raises the age-old problem of moral hazard. Does one “bail

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<sup>37</sup> Fischer, Stanley. Learning the Lessons of Financial Crises: The Roles of the Public and Private Sectors. Speech given at the Emerging Market Traders’ Association Annual Meeting, New York, December 9, 1999.

<sup>38</sup> Camdessus, Michael. Second Generation Reforms: Reflections and New Challenges. Remarks to the IMF Conference on Second Generation Reforms. Washington, November 8, 1999.

out” banks or other financial institutions that engaged in unsound lending in order to keep the economy going knowing that such bailouts will encourage further unsound lending in the future? Should banks that cannot meet minimum capital adequacy standards be allowed to continue lending – particularly if their source of funds is a quasi-governmental bank – even though the threat of massive bank closings causes such a crisis of confidence in the banking system that it has major negative effects on the economy? These questions are not easy to answer, and future policies to contain financial panic probably will have to include a delicate mix of actions that include both harsh and supportive policies toward financial institutions. With respect to the international capital adequacy standards for banks, the Basel (Switzerland) Committee on Banking Supervision in June 1999 proposed that the existing standard be overhauled. This issue now is being debated in international financial circles. The new standard would address problems of risk management more completely.<sup>39</sup>

**Poor Forecasts.** A further criticism by Sachs of the IMF is that almost every prediction it has made about the Asian financial crisis and its own “bailout” programs have been proven wrong. Specifically, Sachs points out that IMF projections of economic recovery were too optimistic and that economies were harder hit than anticipated. In retrospect, not only IMF economists, but few other economists or observers, foresaw the severity of the Asian financial crisis. The crisis was outside the range of immediately probable events. Still, the IMF could have benefitted from the experience of experts from the World Bank, Asian Development Bank, and other Asian institutions during the early stages of the crisis who voiced opinions that the IMF requirements appeared too stringent. In the South Korean case, recovery is proceeding faster than anticipated at the beginning of the crisis.

**IMF Accountability.** Sachs states that the IMF is not being held accountable for its actions and the details of the “advice” it imposes on the developing world. He points out that the IMF is loath to disclose information to the public who need it to protect their investments and to evaluate IMF policies. IMF program documents have not been open to public debate and critical scrutiny. The IMF counters that by disclosing certain sensitive financial information about countries, it would run the risk of causing the very financial panics it was trying to prevent. During the Asian financial crisis, however, several IMF documents related to the South Korean support program were posted on various Korean Internet sites. The IMF with the permission of the countries involved, therefore, is making public on its Internet home page documents that deal with IMF-supported programs of reform and adjustment. The IMF also is now having external evaluations conducted of its surveillance and economic research.

**IMF Not Attuned to Needs of Poor Nations.** Sachs also claims that the IMF is dominated by the United States, Europe, and Japan and is not attuned to the special needs of developing nations – such as alleviating poverty. The IMF and its supporters respond that problems of economic development and poverty have been the purview

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<sup>39</sup> Engelen, Klaus C. Shoot-Out at the Basel Corral. *The International Economy*, January/February 2000. pp. 46-49.

of the World Bank and other development banks rather than of the IMF. However, after the Asian financial crisis threw some 20 million people into poverty and certain officials of the World Bank publicly expressed dissatisfaction with IMF actions, the IMF has been shifting its policies more toward poverty alleviation. In a 1999 speech, Stanley Fisher, the First Deputy Managing Director of the IMF, said that the Asian financial crisis had been terrible and had taken a high toll on many people, especially the poorest and most vulnerable in society.<sup>40</sup> The IMF has joined with the World Bank in a joint strategy to make poverty reduction the centerpiece of their joint strategies in the 75 poorest countries of the world.<sup>41</sup> Other analysts fault both the Sachs criticism and the IMF defense by arguing that poverty alleviation aid reflects “old thinking” and that sound market-friendly economic and fiscal policies are still the best way to promote development.

As for the large influence of the United States, Europe, and Japan in the IMF, voting power in the IMF is based primarily on subscriptions to the IMF’s capital base. Currently, the United States holds about 18% of the votes. Since decisions require an 85% majority of the IMF’s total voting power, the U.S. effectively holds veto rights in the organization. This, of course, gives it considerable authority in determining IMF policies – despite the fact that traditionally, the IMF is headed by an European.

In summary, many of the criticisms by Jeffrey Sachs of the IMF with respect to the Asian financial crisis have been incorporated – to a certain extent – into the operations of the institution. Whether the changes in IMF operations and policies come from its own internal thinking and policy reviews or from the criticism of outsiders like Sachs, however, is unclear. Most likely, the changes resulted from a combination of policy failures, outside criticism, and internal institutional thought. Even with the changes the IMF has made, however, it still has encountered problems in attempting to assist countries, such as Russia and Brazil, as they have been confronted with financial crises. As IMF programs have hit snags, Sachs continues to critique the institution and its policies and will probably continue to do so into the future.

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<sup>40</sup> Fisher, Stanley. *The Road to a Sustainable Recovery in Asia*. Speech before the World Economic Forum, Singapore, October 18, 1999.

<sup>41</sup> Camdessus, Michel. *From the Crises of the 1990s to the New Millennium*. Remarks to the International Graduate School of Management, Palacio de Congressos, Madrid, Spain. November 27, 1999.



## Appendix<sup>42</sup>

### Relevant CRS Products

Readers desiring further information about the Russian and Asian situations might consult the following CRS products:

Raymond J. Ahearn. South Korea's Economic Prospects. CRS Report RS20041, February 1, 1999.

William H. Cooper and John P. Hardt. Russian Capital Flight, Economic Reforms, and U.S. Interests: an Analysis. CRS Report RL30394, December 27, 1999.

Global Financial Turmoil and the International Monetary Fund. CRS Info Pak IP245G. Updated continuously.

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John P. Hardt. Russia's Economic Policy Dilemma and U.S. Interests. CRS Report RL30266, July 23, 1999.

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Dick K. Nanto. Global Financial Turmoil, the IMF, and the New Financial Architecture. CRS Report RL 30272, July 15, 1999.

Jonathan E. Sanford. Multilateral Development Banks: Issues for the 106<sup>th</sup> Congress. CRS Issue Brief 96008. Updated continuously.

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These are listed in reverse chronological order. Full-text versions are available by calling CRS at 7-5700 or FAX 7-6745. Additional references may be found in the footnotes to the text.

3/3/2000: "IMF mission to Visit Moscow After Presidential Election." Interfax Russian News.

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<sup>42</sup> Prepared by Robert Howe, CRS Office of Information Resources Management.

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- 1/22/2000: World Bank’s Stiglitz vs. Camdessus,” [editorial]. Moscow Times.
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- 01/2000: “Democratic Development as the Fruits of Labor,” by Joseph Stiglitz. Keynote address to the Industrial Relations Research Association, Boston.
- 12/22/99: “U.S. Blocks Aid to Russian Oil Company,” by David E. Sanger. New York Times.
- 12/18/99: “The Bumpy Ride of Joe Stiglitz.” The Economist.
- 12/8/99: “Invisible Hand or Chaos? Theories on How Markets Work May Diverge Sharply But All Help Our Understanding of the Efficiency of Market Economies,” by John Kay. Financial Times.
- 12/7/99: “IMF’s Camdessus Reviews Status of Russian Program.” News Brief no. 99/91. Available on the Internet at the IMF website: [www.imf.org/external/np/sec/nb/1999/NB9981.htm].
- 12/3/99: “Stiglitz’s Return to Research Has Economists Rejoicing,” by Jagdish Bhagwati. New York Times.
- 12/3/99: “Stiglitz: A Dissenter’s Uneasy Role,” by Louis Uchitelle. International Herald Tribune.

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[[www.stratfor.com/cis/commentary/c9912020015.htm](http://www.stratfor.com/cis/commentary/c9912020015.htm)].
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