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Global Financial Turmoil, the IMF, and the New Financial Architecture

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Global Financial Turmoil, The IMF, and the New Financial Architecture

Summary

The economies of the world appear to be heading into a simultaneous slowdown and possible global recession that could bear significant consequences for U.S. and world employment, government finances, stock markets, international trade, and capital flows. The poor economic outlook has been clouded even further following the terrorist attacks on September 11, 2001. There has been a sharp curtailment of activity in industries such as travel and tourism, a drop and slow recovery in stock markets, and sagging consumer confidence not only in the United States but in numerous other countries.

Unlike the Asian financial crisis of 1997-99 when economic strength in the United States and Europe offset weakness in Asia, Russia, and Brazil, this time all major economies seem to be slowing at the same time. The U.S. response to this global downturn has entailed and may require additional action by the U.S. Federal Reserve, the Bush Administration, and the Congress in concert with the International Monetary Fund (IMF) and other multinational organizations.

Congressional interest in this issue is related to: (1) the effects of global economic turmoil on the U.S. economy, (2) operations of the International Monetary Fund, (3) U.S. responses to globalization, and (4) U.S. policies to stimulate the economy. Among these policy issues, this report will focus on the spread and effects of the economic turmoil with a focus on Asia.

In seeking a new world financial architecture, policymakers are trying to improve the international monetary and financial system, to reduce the risk that systemic crisis will recur, and to ensure that, when isolated country crises do happen, there are early warnings, effective policy tools, adequate resources, and broad support to help nations withstand difficult external conditions.

Several studies have examined the role of the International Monetary Fund in financial crises. The IMF, itself, also has been reviewing its policies and operations in light of severe criticism from various quarters. It has begun to take more preventative measures, has increased transparency, and is working with nations to improve their standards, economic policies, and measures to prevent financial crises from occurring.

Since the United States is the largest economy in the world, global economic conditions depend greatly on the state of the U.S. economy. As the nascent recession in the United States has pulled down other economies, a strong recovery could do much to lift the economies in the rest of the world. This can be pursued primarily through monetary and fiscal policies – both domestic and coordinated with those of other nations – and international trade policy being pursued to increase global market efficiency and to ameliorate the adverse effects of foreign unfair trade practices.

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Global Financial Turmoil, The IMF, and the New Financial Architecture

*Most Recent Developments*¹

- **JAPAN** The government revised the real GDP data for the second quarter, now showing a 2.9% annual rate decline – a slight improvement over the first estimate, which showed a 3.2% drop. Nominal GDP still fell at a 10%-plus rate. (Nov. 13, 2001)
- **EURO ZONE** The European Central Bank lowered its main interest rate by 50 basis points to 3.25%, its first move since its 50 basis point cut on September 17. Central banks around the world are reducing interest rates to counter the potential major adverse global economic and financial-market implications of the September 11 terrorist attacks on the United States. (Nov. 8, 2001)
- **ARGENTINA** Facing default on its debt, Argentina unveiled a debt-swap plan to exchange \$60 billion in existing government bonds for new ones carrying lower interest rates. Bond-rating agencies on Wall Street considered this a “selective default” on its \$132 billion debt and downgraded its rating to junk bond status. (Nov. 6, 2001)
- **UNITED STATES** Real GDP growth fell 0.4% in the third quarter (annualized), following a 0.3% increase in the prior quarter. On the positive side, this decline is less dramatic than expected. On the negative side, this will probably mark the first quarterly dip in the economy, with another decline to follow in the fourth quarter. The last two economic contractions were in the first quarter of 1993 (0.1%) and the first quarter of 1991 (2.0%). (Oct. 31, 2001)
- **APEC OUTLOOK** The Asia Pacific Economic Cooperation forum released its 2001 Economic Outlook which concluded that prospects for the year remain weak, as the negative impact of the global cyclical downturn rippled through and dampened business and consumer confidence. APEC had lingering concerns about the inventory adjustment in the information technology sector, more difficult financing conditions in some emerging economies, weakening corporate profitability and downward adjustment in equity prices, slower than expected recovery in the U.S., continued

¹ See the Appendix for an archive of these developments.

slow growth in the euro area, and a possible slip back of the Japanese economy. The report asserted, however, that a reasonably good prospect existed for an early rebound in growth in 2002. (October 18, 2001)

- **UNITED STATES** Consumers' desire to spend came to a standstill in September following the terrorist attack. Households were glued to their television sets for news updates after the attack occurred and never recovered their interest in shopping. Retail sales plummeted 2.4% following a 0.4% increase in August. Purchases of big-ticket items were hurt most. Auto sales fell 4.6%; excluding auto, retail sales were still down by 1.6%. (October 12, 2001)
- **CAPITAL FLOWS** The Institute of International Finance projected net private capital flows to emerging market economies to fall sharply from \$167 billion in 2000 to about \$106 billion in 2001 as a result of the terrorist attacks, global slowdown, and earlier crises in Argentina and Turkey. (September 20, 2001)

Introduction

The economies of the world appear to be heading into a simultaneous slowdown and possible global recession that could bear significant consequences for U.S. and world employment, government finances, stock markets, international trade, and capital flows. The poor economic outlook has been clouded even further following the terrorist attacks on September 11, 2001 in the United States, even though industrialized nations around the world have taken action to ease monetary policies in an attempt to forestall further declines in economic growth rates. There has been a sharp curtailment of activity in industries such as travel and tourism, a drop and slow recovery in stock markets, and sagging consumer confidence not only in the United States but in numerous other countries.

Unlike the Asian financial crisis of 1997-99 when economic strength in the United States and Europe offset weakness in Asia, Russia, and Brazil, this time all major economies seem to be slowing at the same time. The U.S. response to this global downturn has entailed and may require additional action by the U.S. Federal Reserve, the Bush Administration, and the Congress in concert with the International Monetary Fund (IMF) and other multinational organizations.

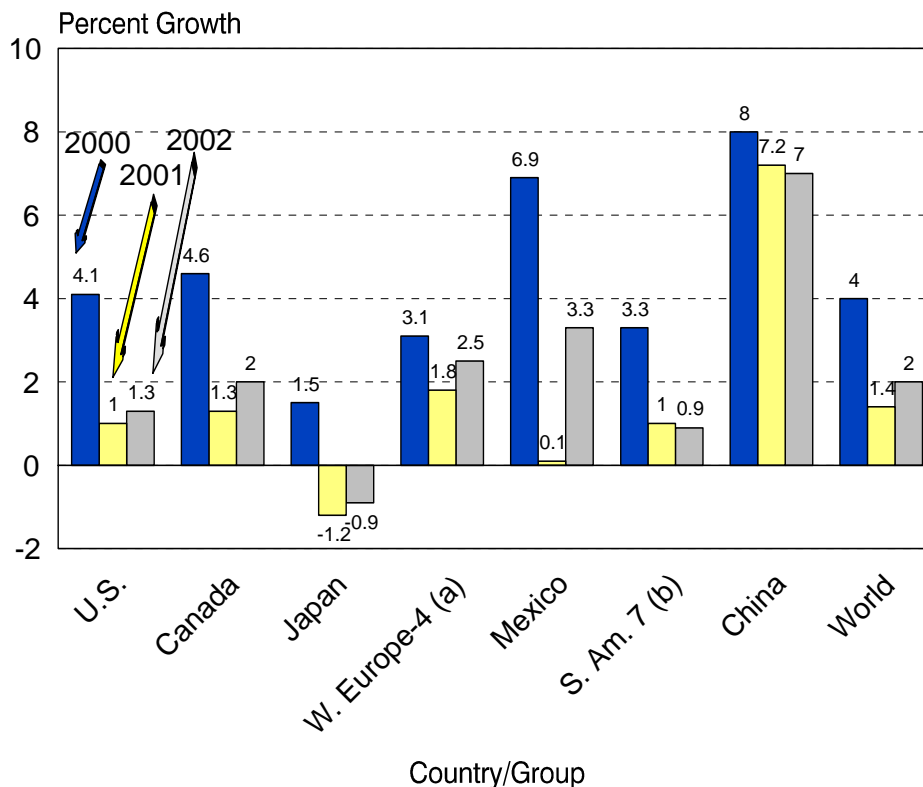
Congressional interest in this issue is related to: (1) the effects of global economic turmoil on the U.S. economy, (2) operations of the International Monetary Fund, (3) U.S. responses to globalization, and (4) U.S. policies to stimulate the economy. Among these policy issues, this report will focus on the spread and effects of the economic turmoil with a focus on Asia. For information on globalization, see CRS Report RL30955, *The Issue of Globalization – an Overview*, by Gary J. Wells and CRS Report RL30891, *Global Markets: Evaluating Some Risks the U.S. May Face*, by (name redacted). For information on the IMF, see CRS Report RL30635, *IMF Reform and the International Financial Institutions Advisory Commission*, by

(name redacted); CRS Report 98-987 *Brazil's Economic Reform and the Global Financial Crisis*, by (name redacted), and CRS Report RL30467 *IMF and World Bank Activities in Russia and Asia: Some Conflicting Perspectives*.

Declining Economic Growth Rates

Following the 1997-99 Asian financial crisis, most countries seemed to be on the path toward recovery and sustained growth. The dip in economic growth rates was short-lived, and except for Indonesia, countries in Asia which had been the hardest hit by the crisis began recovering relatively quickly. In 2000, world economies grew by an average of 4.0% with strong growth in gross domestic product (GDP) in the Former Soviet Union (7.8%), North America (4.1% in the U.S., 4.6% in Canada), Asia/Oceania (4.0%), South America (3.3%), and Western Europe (3.5%). For 2001, world growth is slowing. The growth rate in global GDP is expected to drop by more than half. The Economist Intelligence Unit forecasts 1.7% for the year, while DRI-WEFA projects 1.4% (both are econometric forecasting firms). Anything below 2% is considered to be recessionary for the world. This would be the most rapid deceleration in world economic growth since the 1974 oil price shock and includes truly recessionary economic conditions for many countries.

Figure 1. Growth Rates in Real GDP for Selected Countries and Country Groups for 2000 and Forecast for 2001 and 2002



Source: DRI-WEFA. a. Fr, Ger, It, UK. b. Arg, Brzl, Chile, Colum, Ecuadr, Peru, Venez.

As shown in **Figure 1**, according to DRI-WEFA, world economic growth is forecast to drop from 4.0% in 2000 to 1.4% in 2001 and then to recover somewhat to 2.0% in 2002. The drop in growth in 2001 is expected to be slightly greater in the United States (1.0% growth in GDP in 2001), Canada (1.3%), and in Japan where growth is expected to drop into negative territory (-1.2%). In Western Europe, the average growth rate for the Big Four – France, Germany, Italy, and the United Kingdom – combined is expected to drop to a sluggish 1.8%. For Latin America, Mexico's growth rate likewise is dropping from 6.9% in 2000 to an expected 0.1% in 2001, while the average for seven South American countries (Argentina, Brazil, Chile, Columbia, Ecuador, Peru, and Venezuela) also drops from 3.3% in 2000 to 1.0% in 2001. The middle-income countries of Asia are dominated by India and China. Beijing and foreign investors are pumping enough money into the economy to keep China at 7.2% growth in 2001, while India's growth is holding at about 5.0%. Among other Asian countries, growth in Hong Kong is expected to plummet from a phenomenal 10.5% in 2000 to -0.3% in 2001. Taiwan is in similar straits as growth is dropping from 6% in 2000 to a recessionary -2.1% in 2001. The economic growth rate in South Korea also is plunging from 8.8% in 2000 to 2.0% in 2001.

During the 1997-99 Asian financial crisis, the United States served as an export market of last resort. In 1998, countries in Asia were able to begin recovery largely by exporting to the booming U.S. market. This time, however, the slowdown in the United States is being spread to many of the countries in Asia that depend on exports to the U.S. market. Particularly in information technology, as the bust in U.S. information technology markets has proceeded, some of the first suppliers to be cut off have been those overseas. Taiwan, in particular, is dropping into recession partly because its exports to the United States of electrical machinery (including integrated circuits) and computers are down. As other countries have slowed, moreover, their demand for imports from the United States also has turned sluggish. Even though overall U.S. exports are declining only slightly, over the first eight months of 2001 U.S. exports to Taiwan dropped 23% and to South Korea fell by 19%. Some of this is attributable to the strong U.S. dollar, but deteriorating growth abroad is a major cause. This is combined with declining consumer confidence and problems still unresolved from the previous financial crisis. Still, the drop in U.S. imports because of the weak U.S. economy is more than offsetting the decline in U.S. exports to cause the overall U.S. balance of trade to improve somewhat.

Contagion in World Financial Crises

How does a financial crisis in one country, such as Thailand in 1997, set off global responses, destroy billions of dollars in wealth, throw millions of people into poverty, and even set off events leading to changes of governments? In the current economic scene, how does economic weakness in one country get transmitted across borders to bring down economic activity in another? What are the roads of contagion for economic conditions?

Economies always have interacted with each other, but globalization has added a new dimension to the international pathways among them. Financial markets today are international in scope and are more linked, volatile, leveraged, and of greater size

than at any time in history. The economies of the world have become more interconnected not only through trade in goods and services but through flows of investment capital, speculative financial activities, and bank loans. These extensive linkages have combined with rapid communications to make currency and stock markets more volatile and easily influenced by events and economic conditions in other countries. Financial investments also have become more leveraged with borrowed funds. When markets suddenly turn, these highly leveraged positions can generate enormous losses (or gains).

The magnitude of the flows of capital among countries also has become huge and unprecedented. A study by the Bank for International Settlements indicates that the volume of foreign exchange transactions in 43 markets has exploded to an estimated \$1.5 trillion per day (after making corrections for double counting) — or about 60 times as great as world trade in goods and services.² Private capital flows have grown to the extent that many countries no longer can maintain adequate foreign exchange reserves to handle sudden outflows or to keep such outflows from pushing down exchange rates. Between 1990 and 1998, the assets of mature market institutional investors more than doubled to reach \$30 trillion — about equal to world gross domestic product. In 2000, net inflows into the United States, the world's largest recipient of capital flows, exceeded \$400 billion. This included a record level of foreign portfolio investment in U.S. equities and corporate bonds.

These increased levels of trade and investment provide the pathways by which business cycles are transmitted from one economy to another. The extent to which foreign economic conditions can affect a particular economy, however, depends on how large the economy is, how large the foreign sector is relative to the rest of the economy, and whether domestic monetary and fiscal policies as well as economic activity go counter to or complement that which is happening in other economies of the world. Each country will experience economic shocks that can be purely domestic, such as the crash of the information technology market in the United States. Other economic shocks can be global, such as a spike in oil prices or a simultaneous downturn in Europe and Asia.

The larger an economy, the less it is likely to be affected by international economic fluctuations. In a world economy of \$31 trillion, the economies of the United States (\$9.8 trillion GDP), the European Union (\$7.8 trillion), and Japan (\$3.4 trillion) are large enough that their domestic economic conditions tend to affect other economies more than they are affected by them. Still, they are not immune to international economic conditions, and international commodity prices, such as that for petroleum, are transmitted to them directly.

For particular countries, the larger its international trade flows relative to the size of its economy, the greater the role trade is likely to have in transmitting effects of foreign business cycles. In the United States and Japan total trade (imports and exports of goods and services) accounts for about 20% of GDP. In major European countries, total trade accounts for more of GDP (about 50%), but much of this is

² Bank for International Settlements. *Central Bank Survey of Foreign Exchange and Derivatives Market Activity 1998*. May 1999. P. 1-4.

trade within the European Community. Canada's trade dependence at about 70% of GDP is quite dependent on trade – particularly with the United States, while smaller, export-oriented countries, such as Singapore, in which trade may account for more than 100% of GDP, are heavily dependent on trade and quite susceptible to fluctuations in external economic conditions.

Over the past three currency crises — the European crisis in 1992, the Mexican Peso crisis in 1994, and Asia financial crisis in 1997 — the best predictor of the path of contagion has been along trade lines. Currency crises have tended to be regional — among those countries that trade the most with each other or trade with similar markets.³ The major reason that currency crises spread along trade lines is that once a country devalues its currency, its neighbors suffer a competitive disadvantage in export markets and in selling to that country.

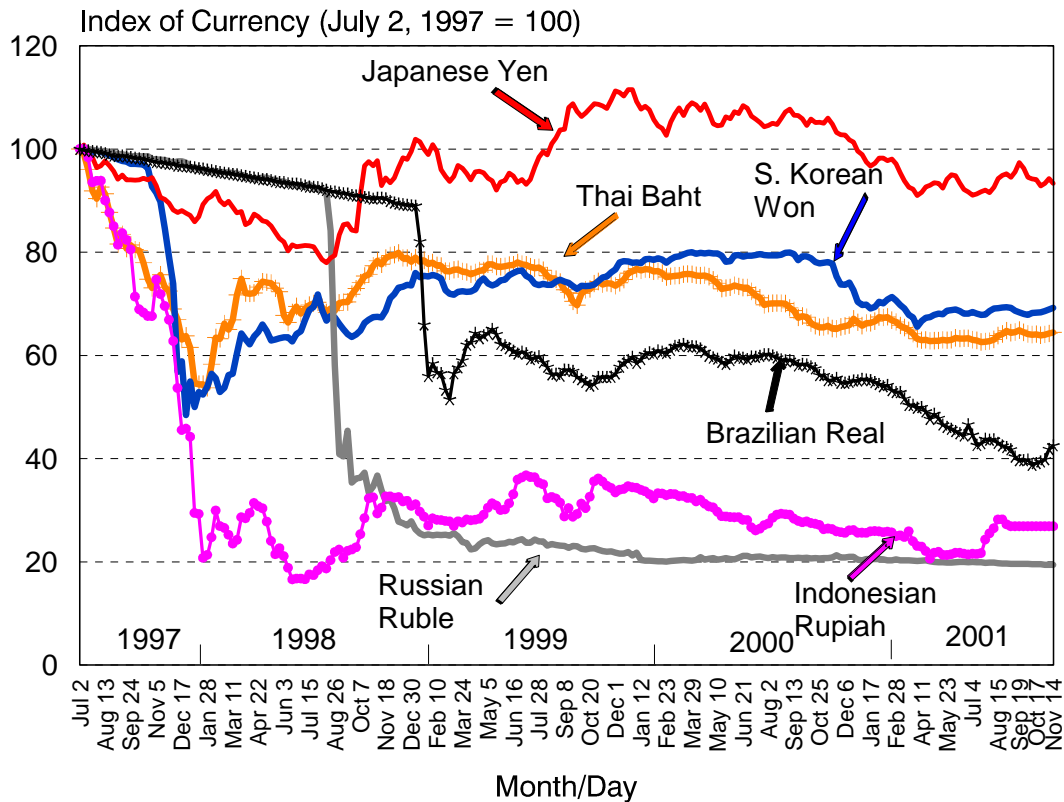
³ How Do Currency Crises Spread? *Federal Reserve Bank of San Francisco Economic Letter*, August 28, 1998. On the Internet at [http://www.frbsf.org/econsrch/wklyltr/wklyltr98/el98-25.html].

Causes of Financial Crises, The Case of Asia

How do financial crises begin? In the case of the 1997-99 Asian case, the global economic turmoil can be traced to many factors – most of them problems with either the financial system or activities by actors in the system. First, there were foreign exchange rates in Asia tied to the appreciating U.S. dollar and too inflexible to adjust to changing trade and capital flows. Second were bankers and corporations who borrowed short-term on international markets to finance long-term investments – some of dubious value – in booming local economies. Third were emerging markets without developed financial infrastructure and with insufficient regulation and market discipline in which the allocation of capital and resources was influenced excessively by personal connections and politics (cronyism). Fourth were highly confident businesses that overbuilt manufacturing capacity and office buildings in Asia and began to default on bank loans. Fifth were real estate and stock market bubbles by which excess liquidity was poured into land and corporate equities creating a euphoria as prices rose but also generating huge losses as prices fell.

Some of the above problems have been corrected as part of the reforms following the Asian financial crisis, but some are so deep-rooted in economies that they remain today. The most progress has been made with exchange rate regimes. Countries now rely on a variety of exchange rate regimes that allow for more flexibility. Some countries, such as China/Hong Kong, Argentina, Estonia, and a number of smaller nations still peg their exchange rate against a single or composite of currencies. Most large economies allow their currencies to fluctuate either freely or within specific crawling bands.

Figure 2. Indexes of Currency Values With Respect to the Dollar for Japan, Thailand, South Korea, Brazil, Russia, and Indonesia July 1997-October 2001



Source: Data from PACIFIC Exchange Rate Service

Figure 2 shows the value of the Thai baht, Indonesian rupiah, South Korean won, Japanese yen, Brazilian real, and Russian ruble relative to the U.S. dollar. The currency depreciation that began in Thailand in July 1997 rapidly spread across southeast Asia and affected other currencies as well. The dramatic fall in the value of the ruble did not occur until August 1998. By March 2000, the South Korean won and Thai baht had recovered to about 80% and the Brazilian real to about 60% of their pre-crisis values. The Indonesian rupiah was at about 32% and the Russian ruble at about 20% of their 1997 values, while in 1999-2000 the Japanese yen had appreciated to a level higher than its pre-crisis level.

Following the September 11, 2001 terrorist attacks, most of these currencies dipped momentarily before recovering. Despite the direct attack on the United States, the lowering of U.S. interest rates, and the prospect that the Federal Government could return to deficit spending, the value of the dollar has been rising. The Japanese yen, in particular, has declined in value. Still, there have been no precipitous drops in exchange values, except that of Brazil, whose rate declined and then recovered. The most precarious situation in late 2001 was in Argentina. It must choose between devaluing its currency, fully dollarizing its economy (adopting the dollar as its domestic currency), or taking similar drastic action.

What is the mechanism by which weakness in one currency drives down the values of other currencies? In order to understand the process, one must recognize that trade flows no longer dominate foreign exchange markets. In times past, foreign exchange was bought primarily for use in foreign trade transactions — for the international buying and selling of goods and services. Now non-trade transactions dominate foreign exchange markets. Capital flows completely overshadow trade flows in value and effect on exchange rates. Foreign currencies are bought by investors seeking higher rates of return, by wealth-holders seeking safety from political or economic instability, by multinational corporations building manufacturing or distribution facilities abroad, by speculators betting on movements in exchange rates, and by others for a variety of reasons. Trade flows remain important, but they are only one factor in determining foreign exchange values.

Because currencies play such a variety of roles in the world financial system, their value fluctuates as underlying financial conditions, macroeconomic variables, investor expectations, and actions of central monetary authorities change. Like stock markets, there is no sure method of predicting short-term movements in exchange rates. Many economists have concluded that, while underlying financial and macroeconomic conditions — such as interest rates, trade deficits, and economic growth rates — influence exchange rates over the long run, in the short run, fluctuations are more random and unpredictable in nature.⁴

For example, in 1997, once Thailand allowed the value of its currency to fall, Malaysia, the Philippines, and Indonesia — neighboring countries that compete in similar export markets — suddenly found their exports significantly more expensive than those of Thailand. Not did this affect their balance of trade, but speculators and other buyers of foreign exchange placed financial bets that those other countries would have to allow their currencies to depreciate also. This unleashed tremendous downward pressures on exchange rates in these countries. In the Asian financial crisis, the lines of transmission led from Thailand to Malaysia, the Philippines, and Indonesia, then later to Hong Kong and South Korea. After that, the problem became more global as it spread to Eastern Europe, Russia and Brazil.

Since underlying macroeconomic conditions affect the long-run exchange rate of a country, speculators and investors may target certain currencies for devaluation if their countries exhibit macroeconomic and financial features similar to the country that has devalued its currency. For example, since Thailand's main problems in 1997 were its weak banks, a rising current account deficit, and an accumulation of short-term foreign currency loans, countries with similar macroeconomic and financial conditions were targeted by speculators. This is one of the reasons that countries with scanty trade ties with a country in crisis also can find themselves subject to currency speculation or capital flight by their own citizens seeking a safe haven to store their wealth. In 1997, for example, as Hong Kong's currency came under attack, speculators also descended upon Estonia's currency. Like Hong Kong, Estonia also has a currency board. In South Korea's case, its currency came under

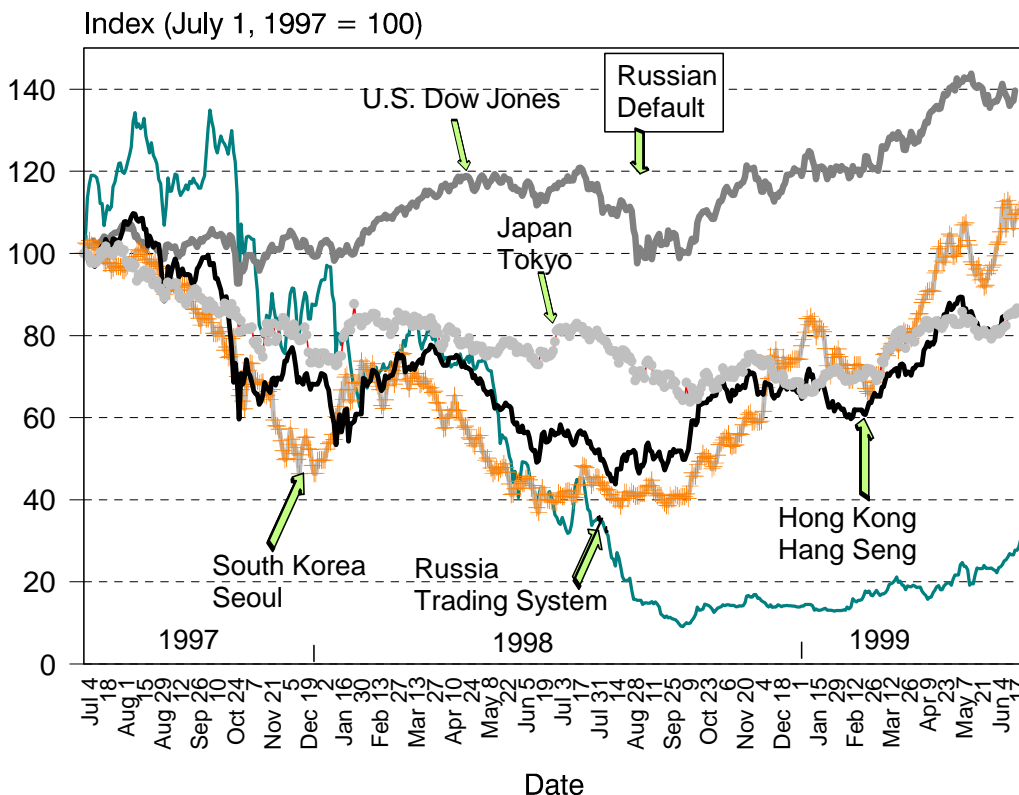
⁴ Frankel, Jeffrey A. and Andrew K. Rose. Empirical Research on Nominal Exchange Rates. In *Handbook of International Economics*, Vol. III, Edited by G. Grossman and K. Rogoff. Amsterdam, Elsevier, 1995. Pp. 1690-91.

attack because it too had a weak banking system, an accumulation of short-term international loans, and other economic conditions that resembled those of the countries of Southeast Asia.

Securities Markets

Fluctuations in currency markets also affect stock and securities markets. The process is two-fold. First, when a currency depreciates it also reduces the value of any asset denominated in that currency such as stocks and bonds. If investors (both foreign and domestic) in national equity markets anticipate a currency depreciation, they may sell their stocks and convert the proceeds into a foreign currency before the depreciation or before the currency depreciates further. Second, when a country is facing a rapidly declining currency, the country's monetary authorities may raise interest rates (to stem capital flight) and adopt restrictive fiscal policies (to raise savings and reassure investors) which may slow economic growth, reduce corporate profits, and raise the return on bonds or money market accounts relative to stocks. Both higher interest rates and lower profits tend to reduce equity values. As funds are moved from a troubled economy to a safer haven (such as the United States or Europe), equity values or bond prices may well be bid up in those safe-haven countries.

Figure 3. Indexes of Stock Market Values for the United States, Japan, Russia, Hong Kong, and Indonesia during the Asian Financial Crisis July 1997-June 99

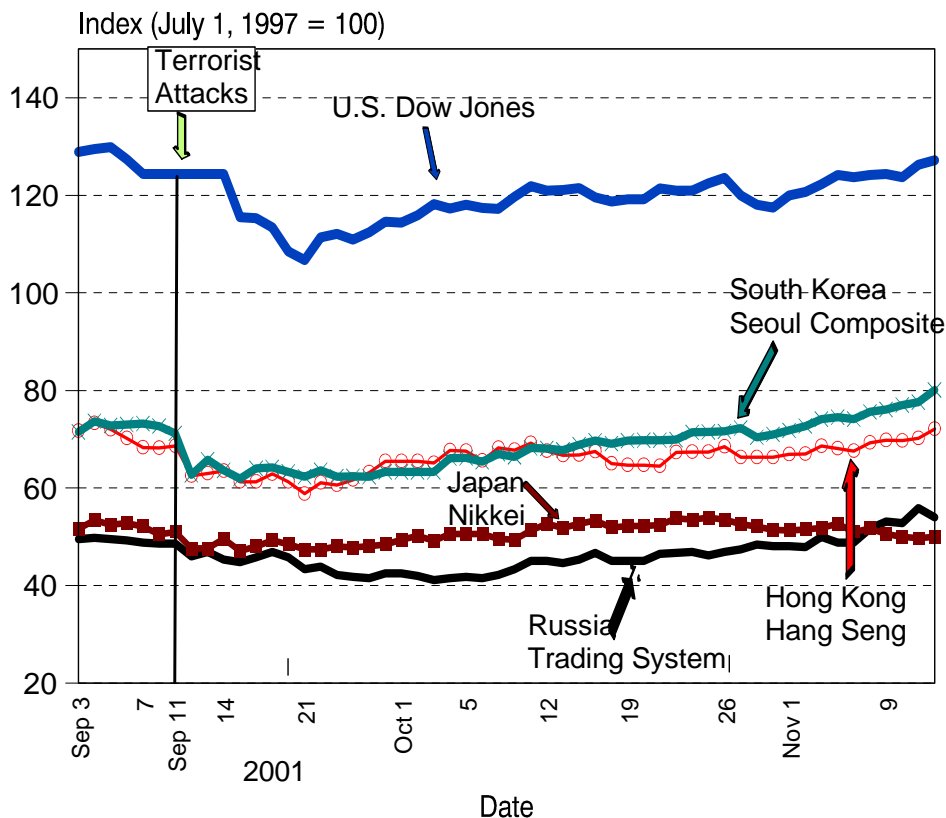


Source: Trendlines, Seoul Composite, Tokyo Nikkei 225, Hong Kong Hang Seng, Russia Trading System & Dow Jones Industrial Indices

During the Asian financial crisis, values on equity markets fluctuated almost as much as currency values. **Figure 3**, shows indices of stock market values on exchanges in the United States, Japan, South Korea, Hong Kong, and Russia over the period of the worst of the Asian financial crisis – from its onset in July 1997 to June 1999. The similar behavior of the Asian markets as well as both the positive and negative effects on the U.S. stock market as measured by the Dow-Jones index is apparent. The market that has recovered the least is the Russian.

As shown in **Figure 4**, the September 11 terrorist attacks on the World Trade Center and Pentagon caused U.S. equity values to drop, despite the additional liquidity provided by the Federal Reserve and reduction in short-term interest rates. By mid-October, however, major stock markets had pretty well recovered to their pre-attack levels. **Figure 4** also shows that since July 1997, the Dow Industrial average has risen about 25%. Japan's Nikkei and South Korea's composite averages, however, still are at 75% to 80% of their July 1997 levels, while those on markets in Russia, Indonesia, and Hong Kong remain at about 50% of their 1997 amounts.

Figure 4. Indices of Stock Market Values for the United States, Japan, South Korea, Russia, and Hong Kong September-November 2001



Source: *Financial Times* Seoul Composite, Tokyo Nikkei Industrials, Hong Kong Hang Seng, Russia Trading System & Dow Jones Industrial Indices

Stock markets can serve as an early barometer and a reflection of the state of economies. For an individual company, if the outlook for its profits diminish, the price of its stock relative to expected earnings will rise, making its stock price expensive relative to other investments such as more secure government securities. This is reflected in the price-earnings ratio (PER or P/E) for stocks. A PER of 20 is roughly equivalent to an investment that pays a return of 5%, since a \$20 investment at 5% would generate a \$1 return each year. In the case of Japan's stock market bubble in the 1980s, PERs reached twice or three times normal levels. For the NASDAQ until its crash in 2000-01, some PERs were as high as 100 or meaningless because firms were not generating any profits at all. Their high stock values were being justified on the basis of future profit potential, much of which never appeared.

In assigning blame for the Asian currency crisis, some pointed the finger at speculators — even though speculators certainly were not to blame for the underlying economic conditions that contributed to the perceived overvaluation of the currencies in the first place. Speculators, often managers of large international investment funds, generate gains by taking advantage of perceived weaknesses in exchange rates. They place financial bets on depreciation (or appreciation) based on their perceptions of underlying forces of demand and supply. They also combine currency speculation with financial maneuvering in derivatives, stocks, securities, and money markets. For smaller emerging markets, these financial actions may trigger currency crises and may be paralleled by similar maneuvering by other investors and businesses engaged in currency transactions.

The mechanics of currency speculation are complicated. Essentially the process involves currency buyers and sellers generating profits from fluctuations in exchange rates by using spot markets (markets for current delivery of foreign exchange), forward or futures markets (markets for future delivery), currency swaps, loans, and other financial maneuvers. The key to this process is that when speculators expect a depreciation in a local currency, they begin short sales (without the currency in hand) of forward or future contracts to deliver that currency at a future date in the hope that they will be able to buy the currency at a lower price before they have to deliver it. They also can speculate in stock market futures by amassing holdings of a currency to dump on the market in order to elicit a response from monetary authorities who often will raise interest rates in order to maintain the exchange rate. The higher interest rates, in turn, cause equity values to fall.

Once a currency begins to show signs of weakening, astute investors and speculators who profit from volatility in exchange markets take actions to minimize losses and maximize gains. The ensuing flight from investments in and holdings of the local currency pushes its value down even further until it often overshoots what would be considered an equilibrium rate. Recovery may be slow.

The International Monetary Fund

The International Monetary Fund began operations in 1947 and now has 183 countries who are members. Its quotas (financial base) are the equivalent of \$272 billion, following a 45% quota increase in 1999. The IMF plays a key role during

international financial crises in coordinating support packages for its member countries experiencing balance of payments difficulties. These packages include loans and secondary lines of credit. The IMF was created to promote international monetary cooperation; to facilitate the expansion and balanced growth of international trade; to promote exchange stability; to assist in the establishment of a multilateral system of payments; to make its general resources temporarily available to its members experiencing balance of payments difficulties under adequate safeguards; and to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members. As of June 30, 2001, the IMF had credit and loans outstanding to 90 countries worth about \$65 billion.

The financial assistance provided by the IMF enables countries to rebuild their international reserves, stabilize their currencies, and continue paying for imports without having to impose trade restrictions or capital controls. Unlike development banks, the IMF does not lend for specific projects. IMF loans are usually provided under an “arrangement,” which stipulates the conditions the country must meet in order to gain access to the loan. All arrangements must be approved by the Executive Board, whose 24 directors represent the IMF’s 183 member countries. Arrangements are based on economic programs formulated by countries in consultation with the IMF and are presented to the IMF Executive Board in a letter of intent (with permission of the borrowing country, letters of intent are posted on the IMF’s Internet site).⁵ Loans are then released in phased installments as the program is carried out.⁶

Financial support packages are initiated by a request to the IMF from the country experiencing financial difficulty. This request then requires an assessment by IMF officials of the conditions in the requesting nation. If a support package is approved, the IMF usually begins with an initial loan of hard currency to the borrowing nation. Subsequent amounts are made available (usually quarterly) only if certain performance targets are met and program reviews are completed. During the Asian financial crisis, the support packages were designed to restore investor confidence — both international and domestic — 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, (2) structural reforms aimed at strengthening financial sectors, and (3) governance issues underlying the crisis which included improving the efficiency of markets, breaking the “crony capitalism” links between business and government in several of the distressed countries, liberalizing capital markets, and providing for more transparency (in disclosing data on external reserves and liabilities).

The volume of loans provided by the IMF has fluctuated significantly over time. The oil shock of the 1970s and the debt crisis of the 1980s were both followed by sharp increases in IMF lending. In the 1990s, the transition process in Central and Eastern Europe and the crises in emerging market economies led to another surge in the demand for IMF resources. Over the years, the IMF has developed a number of loan instruments, or “facilities,” that are tailored to address the specific circumstances of its diverse membership. Non-concessional loans are provided

⁵ On Internet at: [<http://www.imf.org/external>].

⁶ International Monetary Fund. *How Does the IMF Lend? A Factsheet*, September 2001.

through five main facilities: Stand-By Arrangements (SBA), the Extended Fund Facility (EFF), the Supplemental Reserve Facility (SRF), the Contingent Credit Lines (CCL), and the Compensatory Financing Facility (CFF). Low-income countries may borrow at a concessional interest rate through the Poverty Reduction and Growth Facility (PRGF).

Except for the PRGF, all facilities are subject to the IMF's market-related interest rate (currently about 4%) which is based on short-term interest rates in the major international markets. The IMF discourages excessive use of its resources by imposing a surcharge on large loans. Countries are expected to repay loans early if their external position allows them to do so.

The major facilities used for stabilizing currencies and preventing financial crises are the Stand-By Arrangements and Extended Fund Facility. The SBA is designed to address short-term balance-of-payments problems and is the most widely used facility of the IMF. The length of a SBA is typically 12-18 months. Repayment must take place within a maximum of 5 years, but countries are expected to repay within 2-4 years. The EFF was established in 1974 to help countries address more protracted balance-of-payments problems with roots in the structure of the economy. Arrangements under the EFF are longer (3 years) and the repayment period can extend to 10 years, although repayment is expected within 4½ -7 years. **Table 1** summarizes the IMF's Stand-By and Extended Fund Facility loans.

As shown in **Table 1**, the largest current borrowers are Argentina, Brazil, Turkey, Indonesia, and the Ukraine. Total Stand-By Arrangements totaled the equivalent of \$37.0 billion, while Extended Arrangements summed to \$12.5 billion.

As a result of the Asian financial crisis, the IMF introduced two new facilities to cope with needs for huge amounts of funds for relatively short terms. Introduced in 1997, the Supplemental Reserve Facility is designed to meet needs for very short-term financing on a large scale. Countries must repay the loan after a maximum of 2.5 years, but are expected to repay one year earlier. All SRF loans carry a surcharge of 3-5 percentage points.

Also established in 1997, Contingent Credit Lines differ from other IMF facilities in that they aim to help members prevent crises. They are designed for countries implementing sound economic policies, which may find themselves threatened by a crisis elsewhere in the world economy because of "financial contagion." The CCL is subject to the same repayment conditions as the SRF, but carries a smaller surcharge.

**Table 1. IMF Lending from Its General Resources Account
Under Stand-by Arrangements and Extended Fund Facilities
As of August 31, 2001**
(In U.S. Dollars)

Member	Date of Arrangement	Expiration Date	Total Amount	Undrawn Balance	IMF Credit Outstanding
Stand-By Arrangements					
Argentina	Mar 10, 00	Mar 9, 03	21,679,104	9,191,027	14,491,604
Brazil	Sep 14, 01	Dec 13, 02	15,544,832	10,840,086	8,491,434
Croatia	Mar 19, 01	May 18, 02	256,000	256,000	138,409
Ecuador	Apr 19, 00	Dec 31, 01	290,214	96,748	193,467
Gabon	Oct 23, 00	Apr 22, 02	118,502	101,581	82,814
Latvia	Apr 20, 01	Dec 19, 02	42,240	42,240	26,840
Lithuania	Aug 3, 01	Mar 29, 03	110,746	110,746	168,360
Nigeria	Aug 4, 00	Oct 31, 01	1,009,843	1,009,843	0
Panama	Jun 30, 00	Mar 29, 02	81,920	81,920	58,624
Peru	Mar 12, 00	Mar 11, 02	163,840	163,840	393,980
Sri Lanka	Apr 20, 01	Jun 19, 02	256,000	123,712	132,288
Turkey	Dec 22, 99	Dec 21, 02	19,249,152	7,299,021	12,412,851
Uruguay	May 31, 00	Mar 31, 02	192,000	192,000	146,176
Yugoslav	Jun 11, 01	Mar 31, 02	256,000	128,000	277,664
Total Stand-by Arrangements			59,250,394	29,636,763	37,014,510
Extended Fund Facilities					
Colombia	Dec 20, 99	Dec 19, 02	2,504,960	2,504,960	0
Indonesia	Feb 4, 00	Dec 31, 02	4,656,640	3,170,816	9,869,235
Jordan	Apr 15, 99	Apr 14, 02	163,686	77,939	452,662
Kazakhstan	Dec 13, 99	Dec 12, 02	421,248	421,248	0
Macedonia	Nov 29, 00	Nov 28, 03	30,867	29,398	36,303
Ukraine	Sep 4, 98	Aug 15, 02	2,457,536	930,496	2,048,539
Yemen	Oct 29, 97	Oct 28, 01	93,312	33,792	82,740
Total Extended Arrangements			10,328,250	7,168,649	12,489,478

Note: IMF SDRs (Special Drawing Rights) converted to dollars at 1.28 dollars per SDR.

Source: International Monetary Fund

During the 1997-99 Asian financial crisis, the IMF arranged support packages initially for Thailand, Indonesia, and South Korea and augmented a credit to the Philippines to support its exchange rate and other economic policies. Later, the IMF extended support to Brazil and Russia. The five support packages are summarized in **Table 2**. The total amounts of the packages are approximate because the IMF lends funds denominated in special drawing rights (SDRs), and because pledged amounts often change as circumstances change. The initial support package for

Thailand was \$17.2 billion, for Indonesia about \$43 billion, and for South Korea \$57 billion. The United States pledged \$3 billion for Indonesia and \$5 billion for South Korea from its Exchange Stabilization Fund (ESF) as a standby credit that may be tapped in an emergency. 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.

In addition to IMF support, recipient countries during the Asian financial crisis tapped funds pledged by the World Bank, the Asian Development Bank or, in the case of Brazil, the Inter-American Development Bank, and by certain industrialized nations. The World Bank, in particular, played a key role in attenuating the negative effects of the financial crises on poorer people who are less able to shield themselves from recessions. In 1998, the World Bank created a Special Financial Operations Unit (SFO) to help respond to financial sector crises. Working closely with the country departments, the SFO's mandate is to provide immediate support to governments to help them stabilize their financial systems, followed by support for structural reforms and resolution of non-viable financial institutions.⁷

Table 2. IMF Support Packages During the Asian Financial Crisis

(Amounts in U.S.\$Billion)

	Thailand	Indonesia	S. Korea	Russia	Brazil
Date Initially Approved	Aug. 20, 1997	Nov. 5, 1997	Dec. 4, 1997	July 20, 1998	Dec. 2, 1998
Total Initially Pledged	\$17.2	\$43.0	\$57.0	\$22.6	\$41.5
IMF	\$3.9	\$18.6	\$21.0	\$11.6*	\$14.7
World Bank	\$1.5	\$4.5	\$10.0	\$2.3	\$4.5
Development Bank	\$1.2 (ADB)	\$3.5 (ADB)	\$4.0 (ADB)		\$4.5 (IDB)
Bilateral	\$10.6	\$24.0	\$22.0	\$1.0	14.5

Note: ADB = Asian Development Bank. IDB = Inter-American Development Bank. Actual amounts disbursed by the IMF's are in SDR's. Development bank figures are for structural adjustment and exclude funds for customary projects.

*The IMF cancelled the 1998 program after disbursing \$4.8 billion. In July 1999, it announced a new program worth \$4.5 billion to be paid in tranches of about \$640 million each. The first was distributed immediately, but the others have been delayed.

Source: IMF, World Bank, ADB, IDB.

⁷ The World Bank. The Special Financial Operations Unit. 1998. On Internet at [<http://www1.worldbank.org/finance/html/sfo.html>].

In Asia, the Association of Southeast Asian Nations plus Japan, South Korea, and China (ASEAN + 3) have established what is called the Chiang Mai Initiative. This is a regional financing arrangement to supplement existing international facilities. The Initiative involves an expanded ASEAN Swap Arrangement for currencies that would include ASEAN countries and a network of bilateral swap and repurchase agreement facilities among the participating countries.

Japan has a special interest in the Asian financial crisis since it occurred within its region and not only affected its close trading partners and competitors but also threatened bank loans and investments by Japanese companies in the area. Japan has been providing financial assistance under what it terms the Miyazawa Initiative (named after their Finance Minister). It includes \$30 billion in loans to Thailand, Malaysia, the Philippines, Indonesia, and South Korea. This was augmented in 1999 with a commitment by Japan to assist Asian nations to mobilize another 2 trillion yen (about \$17 billion) in domestic and foreign private-sector funds for Asia.⁸

Criticism of the IMF

Following the Asian financial crisis, the IMF came under increased scrutiny and criticism. Various groups and commissions have recommended changes to the methods and scope of its operations. For Congress, on March 8, 2000, the congressionally mandated International Financial Institution Advisory Commission submitted its report.⁹ The Commission considered the future roles of seven international financial institutions: the International Monetary Fund, the World Bank, three regional development banks, the World Trade Organization, and the Bank for International Settlements. With respect to the IMF, the Commission made the following recommendations:

- The IMF should be restructured as a smaller institution with three major purposes: (1) to serve as a quasi lender of last resort (standby lender to prevent panics) to emerging economies, but its lending operations should be limited to the provision of liquidity (short-term funds) at penalty interest rates (above the borrower's recent market rates) to solvent member governments when financial markets close; (2) to collect and publish financial and economic data from member countries and disseminate those data in a timely and uniform manner; and (3) to provide advice (but not impose conditions) relating to economic policy as part of regular consultations with member countries.

⁸ Japan. Ministry of Finance. Resource Mobilization for Asia: The Second Stage of the New Miyazawa Initiative. May 15, 1999. On Internet at [<http://www.mof.go.jp>].

⁹ International Financial Institution Advisory Commission. *Report of the International Financial Institution Advisory Commission*. Allan H. Meltzer, Chairman. March 8, 2000. The members of the commission included Allan H. Meltzer, C. Fred Bergsten, Charles W. Calomiris, Tom Campbell, Edwin J. Feulner, W. Lee Hoskins, Richard L. Huber, Manuel H. Johnson, Jerome I. Levinson, Jeffrey D. Sachs, and Esteban Edward Torres.

- The IMF should be precluded from making other than short-term loans to member countries, particularly long-term loans in exchange for compliance with conditions set by the IMF.
- The IMF's Poverty and Growth facility should be closed and its long-term assistance to foster development and encourage sound economic policies be the responsibility of a reconstructed World Bank and regional development banks.

The Commission listed four “pre-conditions” for a country to qualify for IMF assistance: (1) a competitive banking system that allows a greater presence for foreign financial institutions; (2) the regular publication of information regarding that nation's outstanding debts and liabilities; (3) commercial banks that are adequately capitalized, and (4) proper fiscal policy. The Commission suggested that these rules be phased in over a five-year period and that they be suspended if necessary for global stability in the event of a major crisis.

Several members of the Commission dissented from the recommendations of the report. The dissent with respect to the IMF centered on the constraints placed on the IMF in combating financial turmoil and on who would qualify for assistance. The four dissenters, for example, argued that the suggested pre-conditions for crisis loans would ignore the macroeconomic policy stance of the country in turmoil, because the IMF would not be authorized to negotiate policy reform. In short, the IMF might end up supporting countries with runaway budget deficits and profligate monetary policies. The pre-qualifying conditions also might preclude support for countries that are critical for global financial stability.¹⁰ Other objections by commission members were that it did not address worker rights or sustainable development issues and that it might undercut the fight against global poverty.

Other studies in the aftermath of the global financial crisis have made recommendations similar to those of the Advisory Commission. In June 1999, the finance ministers of the G7 (Group of Seven Industrial Nations) recommended reforms in six priority areas:

- strengthening and reforming the international financial institutions and arrangements;
- enhancing transparency and best practices;
- strengthening financial regulation in industrialized countries;
- strengthening macroeconomic policies and financial systems in emerging markets;
- improving crisis prevention and management, and involving the private sector, and
- promoting social policies to protect the poor and most vulnerable.¹¹

¹⁰ C. Fred Bergsten, Richard Huber, Jerome Levinson, and Esteban Edward Torres. Dissenting Statement (to the International Financial Institution Advisory Commission report). c. March 6, 2000.

¹¹ G7 Finance Ministers. *Strengthening the International Financial Architecture*, Report of (continued...)

In February 1999, the G7 established the Financial Stability Forum which has endorsed a broad range of concrete policy actions to address concerns related to highly leveraged institutions, volatile capital flows, and offshore financial centers. The Forum aims to promote international financial stability through enhanced information exchange and co-operation in financial supervision and surveillance. It comprises national authorities responsible for financial stability in significant international financial centers, international financial institutions, international supervisory and regulatory bodies, and central bank expert groupings.¹²

A separate study by the Council on Foreign Relations chaired by Carla Hills and Peter Peterson makes recommendations aimed at altering the behavior of emerging-market borrowers and their private creditors in ways that would reduce vulnerabilities in the exchange rate systems of emerging economies; inducing private creditors to accept their fair share of the costs of crisis resolution; reforming the IMF's lending policies; and refocusing the mandates of the IMF and the World Bank on leaner agendas.¹³

Treasury Secretary Paul O'Neill, in a statement before Congress, put forth the following as policy considerations for the IMF:

- The IMF should focus more on its core objectives which are to: (1) promote sound monetary, fiscal, exchange rate and financial sector policies, (2) carefully monitor economic conditions, and (3) deal with critical problems in the international financial system as soon as they are detected in order to provide greater financial stability and facilitate trade.
- The IMF should put more effort into crisis prevention, including the pursuit of sound policies by countries, the development of robust financial sectors, and the adoption of internationally accepted standards and codes.
- The IMF needs more transparency, particularly in releasing information and assessments to the private sector in order to enable markets to make informed judgements and to give countries strong incentives to pursue sound policies.
- The IMF should increase its accountability to IMF shareholders and taxpayers.

¹¹ (...continued)

the G7 Finance Ministers to the Köln Economic Summit, Cologne, June 18-20, 1999.

¹² Financial Stability Forum (Basle, Switzerland). Financial Stability Forum Endorses Policy Actions Aimed at Reducing Global Financial Vulnerabilities. Press release No. 7/2000E, March 26, 1999.

¹³ Council on Foreign Relations. *Safeguarding Prosperity in a Global Financial System: The Future International Financial Architecture*. 1999.

- The IMF should not create expectations that reduce the incentives for countries and for individuals to take policy actions essential to prevent crises. Expectations of continued or additional financial support in the case of poor policy decisions in a country reduce the incentives to make good economic decisions. Moreover, expectations that countries can and will use IMF financial support to meet payments on debt instruments held by the private sector reduce due diligence required to make sound financial decisions.
- The IMF should focus its work on areas in which it has expertise and responsibility rather than to use conditions on its loans to go beyond relevant macroeconomic reforms within its expertise.¹⁴

The IMF Response and New Financial Architecture

The IMF, along with the World Bank and member governments, have been addressing the above criticisms and problems in the international financial architecture. This architecture is the institutions, markets, and practices that governments, businesses, and individuals use when they carry out economic and financial activities. The underlying goal is to build a stronger, more stable international financial system that will make the world less vulnerable to financial crises, while allowing all countries to benefit from the process of globalization.

To date, the most progress by the IMF has been in:

- the increase in the quality and candor of economic information that governments and other institutions are making available to the public;
- the growing implementation of codes of good practices that are essential to a well-functioning economy; and
- the creation of Contingent Credit Lines (CCL), an IMF facility that enables the Fund to lend preemptively to help prevent a crisis.¹⁵

A fundamental criticism of IMF and governments during the Asian financial crisis was that insufficient information was available to the public to protect their investments and to determine what actions the IMF and government were taking. Some also asserted that the IMF kept information confidential that might have warned investors of potential problems, although release of such information, itself, might trigger precisely the financial crisis the country and the IMF would be attempting to avoid. Governments also were not gathering sufficient data on financial transactions to assess their exposure to a tightening of credit or financial

¹⁴ O'Neill, Paul H. Statement before the House Committee on Financial Services, May 22, 2001. U.S. Department of Treasury, PO-392.

¹⁵ International Monetary Fund. *Progress in Strengthening the Architecture of the International Financial System, A Factsheet*. July 31, 2000

panic. The IMF now releases (with member government permission) Public Information Notices and staff reports following consultations (under article IV) with member countries, Letters of Intent, and other documents. The Letters of Intent, in particular, provide detail on the actions being required as a condition of loans. The IMF also is releasing statements of the Chairman of its Executive Board summarizing the board's views following discussions of a member's use of Fund resources. Most of these documents are available on the IMF Internet site.

The IMF also claims that substantial progress has been made in developing and assessing internationally accepted financial standards. Standards and codes of good practices help ensure that economies function properly at the national level, which is a key prerequisite for a well-functioning international system. In consultation with others, the IMF has developed Special Data Dissemination Standard; the Code of Good Practices on Fiscal Transparency; the Code of Good Practices on Transparency in Monetary and Financial Policies; and guidelines concerning financial sector soundness. Currently, 47 countries subscribe to the IMF's Special Data Dissemination Standard, which encourages member countries to provide detailed and reliable national economic and financial data.

A third area of focus for the IMF is in financial sector strengthening, particularly the ability of banks and other financial institutions to improve internal practices, including risk assessment and management; and upgrading supervision and regulation of the financial sector to keep pace with the modern global economy. The IMF and the World Bank have intensified and enhanced their assessment of countries' financial systems through joint Financial Sector Assessment Programs which serve to identify potential vulnerabilities in countries' financial systems. The Basle Committee on Banking Supervision also is addressing gaps in regulatory standards.

A strong criticism of the financial support programs coordinated by the IMF during the Asian financial crisis is that those programs may have created a moral hazard (causing more risky behavior by reducing the adverse consequence of it). If lenders know the IMF will "bail out" countries unable to repay international debts, for example, lenders may extend loans with risks higher than those reflected in the interest rate and other terms of the loans. The IMF claims, however, that it works under the basic operating principle that its financing should not relieve debtors or creditors of their responsibility for the risks they take. Holders of equity incur financial losses immediately as values on stock markets decline. Holders of loans, however, may not see immediate losses because IMF loans may provide the foreign exchange for countries to service foreign loans. In the resolution of financial crises, therefore, the IMF is to involve the private sector more in the resolution of crises, particularly lenders and holders of bonds. This may require actions such as debt restructuring by creditors.

During the Asian financial crisis, the IMF was criticized severely for imposing conditions on its loans that were viewed as too severe for the countries in turmoil. Many blamed IMF conditions that resulted in fiscal stringency and high interest rates for causing economies to turn downward more than was necessary and throwing millions of people into poverty. A particular complaint was that the IMF tended to require that central government budgets be balanced or in surplus despite the need

for fiscal stimulus to combat recessions and to provide a social safety net for the growing numbers of unemployed workers.

The IMF still views conditionality as indispensable for safeguarding the Fund's resources. It requires certain actions by member governments to ensure that its loans are used appropriately to promote adjustments considered to be necessary to prevent future crises. The IMF, however, also claims that it recognizes that countries cannot carry out major structural changes overnight. The Fund, therefore, asserts that, henceforth, it intends to focus conditionality on those measures that are critical to the macroeconomic objectives of country programs. The IMF states that will not weaken conditionality but make it more efficient, effective, and focused. There also is broad agreement within the IMF that the Fund must promote good governance in borrowing countries, both through initiatives – such as the work on standards and codes – and through specific measures to improve the decision making and administrative processes in government and the private sector.

In 2001, as world economies have been slipping into recession, the IMF is taking measures to keep the world economy on track.¹⁶ It particularly is working closely with countries such as Argentina to ensure that slowing world economic activity does not trigger another international financial crisis. This is a test to see if the new international financial architecture is able to prevent another global financial crisis.¹⁷

U.S. Economic Policy

Since the United States is the largest economy in the world, global economic conditions depend greatly on the state of the U.S. economy. As the developing recession in the United States has pulled down other economies, a strong recovery could do much to lift the economies in the rest of the world. This can be pursued primarily through monetary and fiscal policies – both domestic and coordinated with those of other nations – and international trade policy being pursued to increase global market efficiency and to ameliorate the adverse effects of foreign unfair trade practices. With respect to monetary policy, while Congress plays an important oversight role, actual policy is determined by the U.S. Federal Reserve in accord with its own assessments. From mid-1999 through most of 2000, inflation remained a threat, and labor markets were tight. The Fed raised interest rates several times to ease labor and price pressures and to provide alternative investments to the high-rising U.S. stock market. As the U.S. economy has slowed, the Federal Reserve has dropped interest rates aggressively. It lowered, for example, its discount rate (the interest rate it charges banks) from 6.0% in 2000 to 5.75% in January 2001 and executed ten more rate cuts until the rate reached 1.5% in November 2001.

¹⁶ Köhler, Horst. *The IMF in the Process of Change*. April 29, 2001. On Internet at [<http://www.imf.org/external/np/omd/2001/state.htm>].

¹⁷ For information on Argentina, see CRS Report RL31169, *Argentina: Economic Problems and Solutions*, by (name redacted).

With respect to fiscal policy, the 107th Congress has been considering various stimulus packages. In September 2001, Congress passed a \$40 billion emergency supplemental appropriation (P.L. 107-38) and the \$15 billion Air Transportation Safety and System Stabilization Act (P.L. 107-42). Various tax cuts provided for by the Tax Relief Reconciliation Act (P.L. 107-16) also are slated to be automatically phased in on January 1, 2001. On October 24, 2001, the House passed the Economic Security and Recovery Act (H.R. 3090) which seeks to stimulate the economy through several tax reductions including changes in capital depreciation deductions, repeal of the corporate alternative minimum tax, acceleration of the phase-in of the 25% marginal income tax bracket adopted in P.L. 107-16, and a supplemental income tax rebate for those who did not receive a full rebate under that law.

As for international trade policy, pressures are building in two areas. The first is in the size of the U.S. trade deficit. The merchandise trade deficit reached a high of \$328.8 billion in 1999 and increased further to a record \$436.1 billion in 2000. The U.S. current account deficit likewise reached \$324.4 billion in 1999 and a record \$444.7 billion in 2000. While these deficits currently are being matched by inflows of capital into the relatively safe U.S. market, the trade imbalance reflects growing pressures on U.S. industries that export to the troubled economies or compete with imports. While reducing the trade deficit, itself, is not necessarily an objective of U.S. trade policy, increasing U.S. exports, enhancing market efficiency through reducing import barriers abroad, and ensuring that imports into the American market are traded fairly are U.S. policy goals. The United States can open markets abroad through trade negotiations, coordinate monetary and fiscal policies to encourage other nations to stimulate their economies more, and impose import barriers to protect U.S. industries from unfair foreign trade practices – particularly dumping.

Appendix: Archive of News Topics¹⁸

- **MEXICO** Mexico's real investment was down 2.9% year over year (y/y) in the first seven months of the year. On a monthly basis, real investment contracted 4.8% y/y in July, which is an improvement from June's 8.5% drop. July's relative improvement was due to a smaller contraction of construction investment (-2.7%). This sector was hit hard in the first half of the year but currently seems to be benefitting from lower interest rates and higher public spending. Meanwhile, investment in equipment and machinery contracted 6.6% y/y in July. (Oct. 9, 2001)
- **TERRORIST ATTACKS** on the World Trade Center and Pentagon caused sharp declines in stock values and are expected to cause consumer confidence to decline and economic activity to slow. (Sept. 20, 2001)
- **TREASURY SECRETARY O'NEIL** at the APEC Finance Ministers meeting stated that the United States could not shoulder the burden of reversing the global slowdown on its own, and that other nations must do their share – particularly Japan, which needed “decisive action” to cure the decade-long economic malaise that has sapped the economic health of the entire region. (Sept. 7, 2001)
- **IMF AND WORLD BANK ANNUAL MEETINGS** scheduled to be held in Washington, D.C. on September 29-30, 2001, were cancelled following the September 11 terrorist attacks. (Sept. 17, 2001)
- **BRAZIL** The IMF approved a 15-month US\$15.58 Billion Stand-By Credit for Brazil in support of the government's economic and financial program through December 2002. (Sept. 14, 2001)
- **ARGENTINA** IMF Managing Director Horst Köhler recommended that Argentina's Stand-by Credit be augmented by \$8 billion to a total of about \$22 billion. (Aug. 21, 2001)

¹⁸ Source: Selected from DRI-WEFA Hot News Topics.

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