

“Preventing Future Financial Crises”

—Lessons from Asian and Latin American
Countries and the Role of the IMF—



Independent Evaluation Office
International Monetary Fund



Institute for International Monetary Affairs

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3-2, Nihombashi Hongoku-cho 1-chome, Chuo-ku,

Tokyo 103-0021, Japan

Telephone: 81-3-3245-6934 Facsimile: 81-3-3231-5422

e-mail: admin@iima.or.jp

URL: <http://www.iima.or.jp>

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Preface

In the late 1990s, a series of capital account crises rocked the global economy. The IMF found itself at the center of this turmoil and criticized as never before. The experience triggered extensive internal and external reexaminations of IMF policies and practices and intensified the attention paid by the IMF to identifying vulnerabilities and preventing and resolving crises. It also encouraged the organization to add an external perspective to its learning culture.

The resulting Independent Evaluation Office (IEO) initiated, in early 2003, a review of the IMF's handling of capital account crises in Indonesia, Korea and Brazil. Its report, released on July 28, chronicles vulnerabilities that were in some cases identified but were in others undetected or under-appreciated; it also examines weaknesses in IMF-supported programs. (Full text of the report is available on its website at <http://www.imf.org/ieo>)

This is a record of proceedings of the symposium on "Preventing Future Financial Crises: Lessons from Asian and Latin American Countries and the Role of the IMF" held on September 16, 2003 at the Imperial Hotel in Tokyo, jointly sponsored by the IIMA and the Independent Evaluation Office of the IMF.

The names of the panelists and organizers are available below. We hope the opinions and discussions presented here will be informative to those who are interested in the capital account crises of the 1990s and their lessons. Please note that all responsibility in compiling these speeches and discussions is solely of the IIMA's, as are any errors in their presentations here.

Presentation :

Dr. Shinji Takagi

Advisor, Independent Evaluation Office of the IMF

Panelists :

Mr. Fausto Medina-López

Deputy Representative

Inter-American Development Bank Office in Japan

Dr. Miranda S. Goeltom

Professor & Senior Research Associate, Faculty of Economics

University of Indonesia

(Former Deputy Governor, Bank Indonesia)

Dr. Il SaKong

Chairman & CEO, Institute for Global Economics, Korea

(Former Minister of Finance, Korea)

Prof. Eisuke Sakakibara

Professor, Keio University

(Former Vice Minister of Finance for International Affairs, Japan)

Mr. Haruhiko Kuroda

Special Advisor to the Cabinet

(Former Vice Minister of Finance for International Affairs, Japan)

Organizer and Panelist

Mr. Montek Ahluwalia

Director, Independent Evaluation Office of the IMF

(Former Finance Secretary at the Ministry of Finance of India)

Organizer and Moderator

Mr. Toyoo Gyohten

President, Institute for International Monetary Affairs

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1. Opening Remarks

M.C. : Thank you very much for attending the IIMA Symposium today under the theme “Preventing Future Financial Crises---Lessons from Asian and Latin American Countries and the Role of the IMF.” We really appreciate your participation. My name is Yamanaka of Institute for International Monetary Affairs, and I will be the MC for today’s symposium.

First, allow me to apologize for the change in the panelists. According to the invitation, we had planned to have as panelist Mr. De Paiva, President of Council of Financial Activities, Ministry of Finance of Brazil, but for reasons he was unable to come to Japan. We, therefore, requested Mr. Medina-López, Deputy Representative of the IDB Office here in Japan whom I will introduce later on to join us and I would like to seek your understanding.

Now let me introduce the panel members. Starting from your left, we have Mr. Ahluwalia, Director of the Independent Evaluation Office of the IMF; Mr. Takagi, Advisor at the IEO; and then Mr. Medina-López, Deputy Representative, Inter-American Development Bank Office in Japan; Prof. Miranda, Professor and Senior Research Associate, Faculty of Economics, University of Indonesia ; Mr. SaKong, Chairman and CEO of Institute for Global Economics of Korea ; Prof. Sakakibara, Professor of Keio University; and Mr. Kuroda, Senior Advisor to the Cabinet. And lastly, seated to your very left is Mr. Gyohten, President of Institute for International Monetary Affairs.

Let me next explain about the way in which we are going to conduct the symposium. First of all, Mr. Takagi, Advisor at the IEO of the IMF, will make a presentation based upon the report on the role played by the IMF in currency crises, and after that we will have the panel discussion and Q and A

session will start at around 11:50. So without further ado I would like to have Mr. Gyohten, President of the IIMA, and also Mr. Ahluwalia, Director of the IEO of the IMF, to deliver their greetings. First, Mr. Gyohten, please.

GYOHTEN : Good morning, ladies and gentlemen. My name is Gyohten of the IIMA. Thank you very much, indeed, for participating in this Symposium organized by the IIMA. I appreciate your presence and participation.

Needless to say, when currency crisis occurred in 1997, that currency crisis had a significant impact not only in Asia but also throughout the world. It was a very important experience for all of us. And in every aspect of this crisis, international institutions, especially the IMF, played a major role, and there is no debate about that. However, frankly speaking, the way in which the IMF designed a prescription for the crisis, how it handled the crisis, had been subjected to various criticisms or dissatisfactions primarily coming from three countries involved in crises.

And bearing that in mind in today's symposium, the report prepared by the Independent Evaluation Office of the IMF is going to be presented and discussed, and we are going to have the panel discussion as well as the interaction with the audience altogether. That is the purpose of this symposium. Fortunately the IMF was kind enough to jointly organize this symposium together with the IIMA, the offer which made me feel very honored. And we do have very eloquent members on the panel, and I am sure their participation would make this symposium all the more important and significant. Needless to say, the most important objective of this symposium is not to rehash the criticism against the IMF, but we need to do our best in preventing future possible financial crises breaking out in the world. And to that end, what countries concerned or what the IMF should be doing is the

major theme of today's symposium. So I want the symposium and the discussion to be very forward-looking and future-oriented.

So here I would like to ask Mr. Ahluwalia, Director of the IEO, to deliver his remarks. Thank you.

AHLUWALIA : Mr. Gyohten, ladies and gentlemen, I would like to just say a few words before we get on to the main session where my colleague, Mr. Shinji Takagi, will actually present our report. On my own behalf and on behalf of the IEO, I would like to thank Mr. Gyohten and the Institute for International Monetary Affairs for making it possible for us to be able to present this report on the three capital account crises before this very distinguished audience. I would like to also thank the very distinguished panelists that we have. We are fortunate in being able to persuade them to come and begin this discussion by presenting expert comments.

This is a new office, and I won't speak for any length of time on it but I have been told by many people that I should just make one point. And that is to emphasize that the Independent Evaluation Office is in fact independent. The report that we are discussing is a report produced by the Office. It was not actually approved by the Management of the IMF in any way. In fact, the procedures of the Office are that when the report is prepared, it is sent to the IMF Management. The IMF Management then makes its comments. The Office then doesn't change the report in the light of these comments, but it makes comments on the Management's comments, and the whole thing then goes to the IMF's Executive Board. So the report that you have, which is being distributed outside, is in that sense a report which has not been cleared by or approved by the Management.

I should also mention that the report was discussed by the Executive

Board and the views of the Executive Board are published as part of the report. So the report you are seeing is really our report, and for your information, in the document that you have you can see the views of the Management, and separately you can see also what the final position taken by the Executive Board was.

I am very happy to say that the report received general endorsement by the Executive Board, which in fact endorsed the broad thrust of our recommendations. We have recognized that ours is by no means the first report to be presented on the subject. After the Asian crises, there was a lot of study within the IMF, a lot of study and criticism outside the IMF, and many distinguished scholars have looked at these issues and come to their own conclusions. But the advantage that we had was complete access to internal IMF records. So, this report is the first major document which is based on knowledge of what went on inside the IMF, and we have had access to IMF staff and management, and we should acknowledge that without this access and help, it would not have been possible to produce this report.

Once again let me say, it's a great honor for Mr. Takagi and myself to be able to come to Tokyo to present this report before this audience, and also to hear the comments of so many distinguished panelists. I would like to say thank you to all of you for coming and to the panelists for agreeing to speak, and most of all to Mr. Gyohten for making it possible for us to come here. Thank you.

M.C. : Now I would like to ask Mr. Takagi, Advisor at the IEO, to start his presentation. Mr. Gyohten, please.

2. The IMF and Recent Capital Account Crises: Indonesia, Korea, Brazil

**Presented by Dr. Shinji Takagi
Advisor, Independent Evaluation Office, IMF**

MODERATOR (GYOHTEN) : Now, ladies and gentlemen, without further ado, I would like to ask Mr. Takagi to present his report. Actually he doesn't require any introduction. He is a well-known figure. After working for the IMF, he served as Professor at the University of Osaka, and currently he is working for the IMF in Advisor capacity. In this Independent Evaluation Office report, Mr. Takagi assumed the role as an overall coordinator. So he is the person who is most qualified to present the report for the purpose of today's symposium. He will be speaking in English.

TAKAGI : Thank you for your introduction. My name is Takagi. President Gyohten, staff members of the IIMA, and also Mr. Hino, Director of the IMF Office here in Tokyo, have extended tremendous support and cooperation to me. Availing myself of this opportunity I would like to express my sincere gratitude for the honor bestowed on me as a speaker in the symposium. I wanted to actually speak in Japanese, but the report was written in English and the power point presentation prepared by the IEO staff is also in English. To make sure that my presentation be accurate, allow me to speak in English.

The Independent Evaluation Office has prepared a report evaluating the role of the IMF in three recent balance of payments crises, Indonesia, Korea, and Brazil. These crises were capital account crises in which a massive reversal of private capital flows played a dominant role in triggering the crises. And in each of these crises, the IMF was called in to help with a crisis management program and a large financial package. At least initially,

however, the IMF's strategy did not immediately restore market confidence quickly. The currency continued to fall sharply, as you can see, as capital continued to flow out, and the adverse balance sheet effect as well as the need to increase domestic savings in the light of capital outflows exerted a massive contractionary impact on the economy. In Indonesia and Korea, GDP registered a significant negative growth.

The manner in which the IMF was criticized for its handling of these crises led to many revisions and innovations in the IMF policies and procedures, including the 2001 establishment of the IEO. Given this background, we had little choice but to evaluate the role of the IMF in these crises, although they took place almost six years ago. The report is to examine the effectiveness of the IMF in surveillance as well as in crisis management.

The purpose of my presentation today, however, is not to summarize what happened so many years ago. To make clear the internal processes by which important decisions were made within the IMF during the crises is important for transparency, and the report does try to do that. Those of you who are interested in what the IMF did are welcome to take copies of the report that is made available outside. And also the report is available at our website. Instead, I would like my presentation today and the panel discussion to follow to be forward-looking.

Much learning has taken place within the IMF and the international community since the crises covered in the report. Additional steps have been taken to make the IMF surveillance and crisis management more effective. Discussion is still on going on issues more broadly related to the international financial architecture. I would like to think that the IEO's contribution also lies here, namely, to provide inputs into this on-going debate on how to

improve the working of the international financial architecture.

I will skip country summaries and I would first present lessons from our evaluation of the IMF's effectiveness in crisis prevention and management. Drawing lessons sometimes requires that we focus on mistakes that were made. In doing so, I am not suggesting that all blames should be placed on the IMF. Clearly, the IMF made errors of both commission and judgment. But at the same time, it is not fair to blame the IMF for everything that went wrong. Errors were also committed by the country authorities, and even by the markets, and some things such as unforeseen political and social developments were beyond the control of what economic policy could achieve. It is only from the standpoint of learning for the IMF that I will now concentrate on what went wrong with the IMF in these countries.

First, pre-crisis surveillance: IMF surveillance was effective in identifying macroeconomic vulnerabilities, as in Brazil, but not as effective in identifying vulnerabilities in financial and corporate sector balance sheets and their macroeconomic implications, as in Indonesia and Korea. The IMF also did not fully grasp the nature and implication of governance problems including corruption and cronyism. Part of the difficulty in identifying financial and corporate sector problems resulted from the unwillingness of the authorities to provide sensitive data and information. Even when vulnerabilities were identified, as in the case of macroeconomic imbalances, the impact of IMF surveillance on the policies taken by the authorities was limited. The confidential advisor role of the IMF was not very effective in any of the three cases.

Second, program design (macro-framework): The IMF supported programs are based on projections for growth and other key variables. There are two problems with IMF projections. First, projections are an outcome of

negotiation with the authorities. Second, they are usually not derived from an explicitly analytical framework. This is not to say that such a framework is needed. In the case of Indonesia and Korea, growth projections were too optimistic, while the projection in Brazil was too pessimistic. Projections in Asia did not fully take into account the possibility of large currency depreciations in a capital account crisis where multiple equilibria could exist and their implications for balance sheets and private investment. The over-pessimism in Brazil in part reflected the learning from Asia where over-optimism turned out to be damaging to market confidence. From the point of view of building confidence, it was thought better to be pessimistic and find the actual outcome to be better than expected. In all three cases the bias in projections led to weaknesses in fiscal policy design.

Next, program design (fiscal policy): In Indonesia and Korea, there was mild tightening initially, but it was soon relaxed as the extent of output collapse became evident. In Brazil, there was strong tightening, but it was not sufficient to stabilize the debt to GDP ratio.

Program design (monetary policy): In all three countries, monetary policy was initially set tight. But how monetary policy evolved during the crises differed across the countries. In Indonesia, the monetary base expanded rapidly in order to support weak banks. It was only when monetary control was regained that the situation began to be contained for the first time. In Korea, monetary policy was eased over the course of several months. In Brazil it was eased more rapidly.

The evaluation does not draw a definitive conclusion about the effectiveness of high interest rate policy in stabilizing the exchange rate. One thing that is clear is that high interest rate policy might have been necessary but was not sufficient by itself . When leverage is high, high interest rates can

have a serious adverse impact on corporate balance sheets.

Program design (financing and private sector involvement [PSI]): What is meant by “PSI” is burden-sharing with private banks and investors in the financing of the capital outflows associated with a crisis. It is often argued that a bailout of the private sector by public money would create moral hazard, leading to excessive risk-taking in investing in emerging markets. The evaluation suggests that the size of financing was an issue only in Korea where ambiguity over the so-called “second line of defense,” additional financing pledged by major industrial countries, was damaging to market confidence. In the absence of an attempt to involve the private sector, the program was under-financed. The situation improved when international banks agreed to roll over exposure to Korea. The IMF played a critical coordinating role, but it was necessary for major countries to intervene, in order for the rollover agreement to take effect.

Program design (bank closure and restructuring): Bank closure and restructuring were necessary in Indonesia and Korea, but not in Brazil. The experience shows that successful bank closure and restructuring require a comprehensive and well-communicated strategy in which transparent criteria are consistently applied. This was initially lacking in Indonesia.

Program design (structural conditionality): Structural conditionality, meaning non-macroeconomic conditionality, was extensive in Indonesia, and to a lesser extent in Korea. The financial measures were probably necessary, but the non-financial measures were probably not critical to crisis resolution, however beneficial they may have been in the long run. In Brazil, structural conditionality was limited to fiscal and prudential areas.

Now let’s move on to recommendations. Since the three crises reviewed

in the report, a great deal of learning has already taken place within the IMF. The evaluation, however, suggests some specific areas where the on-going initiatives or the past initiatives could be enhanced. We give six sets of recommendations.

Recommendation 1: In order to increase the effectiveness of surveillance, Article IV consultation should take a stress-testing approach to a country's exposure to a potential capital account crisis. One of the things we recommend in our report is that the staff report should itemize the major potential shocks the economy could face and explore their real and financial consequences. Staff should also develop a greater understanding of the political constraints that may affect policy-making and of market perspectives through a wider dialogue.

Recommendation 2: Improve the impact of surveillance through greater candor and transparency in staff assessment. In order to increase the impact of surveillance, staff assessment should be candid about potential vulnerabilities and be made public. In order to encourage greater candor in the assessment of country risks and vulnerabilities, IMF management and Executive Board should provide staff with appropriate institutional incentives.

The IMF plays three potential roles in surveillance. First, the role as a confidential advisor. Second, the role of providing peer pressure through the Executive Board. Third, the role of providing quality information to the markets and to the public. As the weight assigned to IMF surveillance shifts in relative importance from the first to the second and then to the third, the role of transparency becomes more important. Much information is now available in the markets on important emerging market economies. The IMF no longer enjoys the same privileged position it had once enjoyed in possession of country-related information. Thus, its role as a provider of

information to the public and the markets should assume an increasing importance.

In order to increase the impact of surveillance, there should be a presumption that the staff reports be published, as opposed to the current practice of voluntary publication. Under the current practice, staff reports on a particular country are released to the public only when the authorities of that country agree. There can be a tradeoff between candor and transparency. When one is afraid that the disclosure of information can alarm the markets, one becomes less candid. When the authorities know that the IMF staff is going to disclose whatever information they provide in confidence, they will become less willing to share confidential information with the IMF staff.

We suggest escalated signaling as a way of striking a balance between the two conflicting needs for candor and transparency. Under escalated signaling, as the authorities fail to take corrective action over several rounds of surveillance where key vulnerabilities are identified, the staff will shift its role increasingly to that of providing peer pressure, then to that of providing information to the public and to the markets, as a way of contributing to public debate on policy. The IMF may not be always right. When there are honest differences of view between the authorities and the staff, the IMF management and the Board should consider seeking second opinions from outside the IMF.

Recommendation 3: Undertake a comprehensive review of the IMF's approach to program design in capital account crises. The proposed review should be oriented around two key elements. First, the objective of a crisis management program is first and foremost to restore confidence. Second, more attention should be paid to the impact of balance sheet interactions.

It is also important to allow for flexible response in case unfavorable

outcomes materialize. All economic variables are inherently subject to uncertainty, but this uncertainty is even greater during a crisis situation. Large potential changes in key variables can render the original program irrelevant very quickly, and the appearance of persevering with a failed program is damaging to market confidence. This suggests that the major risks to the program should be identified explicitly, along with a broad indication of how policies will respond. And we should also avoid imposing reforms that are not critical to crisis resolution.

Recommendation 4: The IMF should ensure that the financing package should be sufficient to generate confidence and also of credible quality.

Recommendation 5: The IMF should be proactive as a crisis coordinator. One thing I would like to emphasize here, in the interest of time, is that IMF management should be frank with the Executive Board and shareholders about the probability of success, and it should identify circumstances where PSI could be useful.

Recommendation 6: This is the last recommendation. Human resource management procedures should be adapted further to promote the development and effective utilization of country expertise within the staff, and to ensure that the centers of expertise on crisis management issues allow for a rapid application of relevant expertise to emerging crises. It is important to maintain dedicated resources to respond to crisis management situations and to learn from past experience. IMF management has already made an organizational change in this direction in the recent reorganization of the Monetary and Financial Systems Department. The same principle should be applied on an IMF-wide basis.

Encouragement of candor requires an institutional mechanism to protect

those who raise uncomfortable issues with the authorities and invite their complaints. In the past, those who invited complaints from the authorities often found it disadvantageous to their career.

I am now ready to hear the expert responses to these lessons and recommendations. Thank you very much.

3. Presentation by Mr. Fausto Medina-López

Deputy Representative Inter-American Development Bank in Tokyo

MODERATOR : Thank you very much, Mr. Takagi, for your candid, extensive but very on-pointed reports. Now I would like to listen to panelists. We have three panelists representing three affected countries, and then two experts from Japan who were also deeply involved in the events that took place during that period of time. Our first panelist is Mr. Fausto Medina-López. He is Deputy Representative of the Inter-American Development Bank in Tokyo. Mr. López.

MEDINA-López : First of all, I want to thank the Organizers for this opportunity to participate in this interesting symposium. Indeed, as the Independent Evaluation Office of the IMF has made quite clear, there are many lessons to be learned from capital account crises, and in Latin America we are quite familiar with those. We have had our larger share than many other regions in dealing with those crises, and for that reason we welcome any lessons that we can learn to help the processing, anticipating and identifying which are the risks and which are the vulnerabilities, and how working together with the member countries we can try to eliminate those risks or to minimize the adverse impact that we may have in the economic, financial, social and political aspects of our member countries.

We are living in an increasingly globalized world in which the closer ties among the countries have become stronger and stronger. The benefits of globalization have been made quite clear in many discussions around the world in many papers. We know that the increased moving of free capital among countries is an important variable in promoting economic growth and

development. We also know that competition among firms is a new element that is supposed to improve the environment for those relationships. Greater trade and investment flows are good for development, are good for the movement of capital, and are good for promoting the social equity objectives that the institutions like the IMF, like the IDB, like bilateral organizations, are looking forward to achieve.

But we also know that along the way with the benefits and the advantages of the increasing globalization, there are some risks associated, some issues associated. So, they have been widely discussed. We listened to some of them in the Cancun Meeting of the World Trade Organization last week, the idea of promoting more social equity, the idea of pushing for more free trade, and the issues of sharing importance in the global discussion.

But in addition to these, the issues related to the contagion effect or the capital account crises are also related to globalization. So, when we are talking about the financial crisis prevention today, we should be keeping that in mind. The capital account crises of the late 1990s in Asia, in Russia, in Brazil, and the most recent ones we have faced in Turkey and Argentina, have proved that there are something, some key variables, that we are supposed to keep in order at the country level in such a way to protect the financial infrastructure that makes the countries work, that makes the countries promote a sustainable and equitable economic development.

As we have discussed, the report of the Independent Evaluation Office of the IMF clearly shows that maintaining of a macroeconomic stability is not any longer just an important development objective but it is a precondition if we are going to promote economic growth and social equity. So, many lessons have been learned from these capital crises of the past seven or eight years. And the Independent Evaluation Office of the IMF has put together a

very good report in assessing those crises, in assessing the impact of those crises, and more important, in making some self-evaluation on the role the IMF played in dealing with the identification of those vulnerabilities and also in the crisis resolution process. So we welcome this report as something very objective, transparent, and identifying some critical elements that can help us to look ahead and to anticipate or to improve the general order.

We know about the Brazilian crisis very much, and we have read very extensively everywhere. So we are quite familiar with the factors that took us to the crises, very similar things in other countries, some of which are specific to Brazil. We know from the beginning the origins of the Real Plan in 1994. It was a well-considered initiative in the beginning, oriented to promote economic growth in Brazil. It had some impact on the reduction of inflation in the country. But also it was associated with some loose fiscal policy that eventually increased the fiscal deficit of the country and had a serious impact on the current problems of the debt sustainability of Brazil. We noticed the problem associated with the foreign exchange regime based on the crawling peg ; in a crawling peg that was leading to an increase in Real appreciation of the Brazilian Real, and we also know how those effects in the difference between interest rates at the domestic market and the international level were attracting a lot of capital flows, which were important for Brazil, but at the same time we were going to have some impact later on, the crises.

So we know, in the context of the Asian crises and later on the Russian devaluation, how those capital flows were coming to Brazil increasingly in the past, you know, from early 1990s, and later on suddenly started reversing. It started reversing when the crisis came, and suddenly it started falling down and having a serious impact. 1998 was an important year for Brazil. It was an election year. It was Mr. Cardoso looking for the second period. He promised

that he was going to implement an austerity program at the end of his period, and he was ready to do that. However, the constraints associated with the performance of the capital market accelerated the search for solutions to prevent a crisis that was in the making.

So, although Brazil was performing relatively well in cutting some capital flows, the crisis in the Long Term Capital Management in the U.S. and the Russian crises made the investors vulnerable and made them realize that something could happen in other places too. In Brazil there was a high level of rising stock of debt which was perhaps where special attention was placed. And that was the origin of crises.

As I said, it has been well discussed, well documented. It has been also presented by Mr. Takagi what was the role of the IMF surveillance. The IMF was not part of the Real Plan. We know that well. And the IMF, with the same reason, was keeping a close consultation with the Brazilian Government. It didn't have a strong role in influencing some of the policy issues that were affecting the country. The IMF was quite aware that the country was facing an over-valuation of exchange rate. The size of that over-valuation was not precise at that moment. Some estimates from the Brazilian side were talking about 10-15 percent of over-valuation. In the real terms in the capital market, the figure was quite different, much higher than that. But the extent of over-valuation was downplayed and had little influence. The IMF had little influence in that particular case in persuading the authorities to make the corrective actions. This is reflected in the Independent Evaluation Office report quite clearly. So they have identified that as an important conclusion of these studies.

So, the IMF went along with the authorities in supporting the crawling peg for a little longer. However, that support was based on the fear that

moving ahead or making some changes in the currency exchange regime of Brazil was going to have some contagion effect. The fear was there, and avoiding the implications that that contagion effect could have was an important consideration at that particular moment. In that case, the role of the IMF or some advisors was not as important, as critical as it could have been, given the relationship that prevailed in the country.

The December 1998 program was the program that was implemented after Mr. Cardoso was re-elected in October 1998, in dealing with those issues, on the one hand in maintaining the crawling peg as the foreign currency regime. Perhaps some people might question right now, or before in the debate, whether or not that was a golden opportunity for the IMF to push ahead for some changes, or maybe to establish wider bands or increase the rate of the acceleration of the peg, or even to move to a floating exchange rate regime. Those considerations have been assessed internally, and the conclusions are in that report. But for some reason the December 1998 program included only some fiscal adjustment commitment to support monetary policy, and it was very limited in structural reforms.

And then we notice that with the pressure that was exercised in Real, in the currency, in December 1998, the crawling peg was no longer sustainable and in favor. It was replaced in January 1999 by a floating exchange rate regime. And in that case, the IMF had been supporting, maybe was not supporting but having been endorsing, the meaning the crawling peg had some impact in terms of credibility. The report also acknowledges that. However, what is important is that the program of December 1998 didn't have a strong political ownership on the side of the country. The authorities were not fully convinced that some adjustments in the area of the foreign currency regime were needed at that particular moment. But the program that was revised in early 1999 corrected those deficiencies. The IMF was very

successful in putting together a program that was more focused on the key issues that would affect the Brazilian economy.

In the monetary level it was established on inflation-targeting, which was the basis for conditionality and which effect had been very positive for Brazil in reducing the inflation, in controlling the inflation. It played a constructive role in moving Brazil to a more fiscal discipline. And this was some of the accomplishments of that program. The approval of the Fiscal Responsibility Law of Brazil was a major element that was a very strong departure from the past experiences.

So it was the positive impact. The macroeconomic projections that Mr. Takagi emphasized were in the pessimistic side. Everybody was expecting that Brazil was going to perform very poorly. But surprisingly the economy recovered, and it had some growth in 1999; not very drastic growth but it was a growth rate of 0.8 percent, which was favorable. And the fiscal situation was being addressed. So, the program has some impact in that sense.

It has entitled fiscal and monetary policies of Brazil. It makes a difference in that sense. The IMF played a catalytic role in making the resources available for Brazil to address those critical constraints. However, the fiscal adjustments, and this is some issue that has been discussed widely now, could have gone a little bit further because the rising stock of the debt in Brazil was becoming a critical issue. And we notice that that particular issue, the debt sustainability, was an issue that came up again in the year 2002, and it's an issue that we look in most of the analyses that have been done on the Brazilian economy presently.

What is important at this moment is that Brazil continues maintaining a

very sound macroeconomic framework. We notice that recently some of the commitments that President Lura da Silva made when he took power are taking place. The country continues a fiscal tightening. It has moved to the Congress of Brazil the new pension system reform, which is supposed to have favorable impact in the fiscal situation of the country. We also notice that the country is trying to move ahead with a tax reform, which was a critical element in the whole fiscal policy adjustment for Brazil.

So, looking ahead about the role, the IMF played an important role, and the revised program was a successful one. We make a similar assessment like the Independent Office Evaluation and the IDB, because we participated in the same aid package, and the conclusion was very similar along the same lines. Lessons learned.

But from here on, what we can say? I mean, the capital crises come and go, and sometimes people question : How we learn something from the process? What can we do? And which directions can we move from now on? What is the difference? And what is true is that we know that an effective surveillance like the IMF is trying to implement is supposed to be very independent, and in that sense, the Independent Evaluation Office is doing a good work in addressing those areas. But much needs to be done, particularly in monitoring which are the macroeconomic frameworks that are prevailing in all the countries? which are the critical policy variables? how is the monetary policy? fiscal policy? how is the banking sector operating?

The close monitoring and surveillance of those variables are important elements to identify along the way which of those problems might become later on a crisis. And working on them, we might be able to try to eliminate the possibility of the crises, or at least to minimize the economic, social, political impacts that those crises might later on generate.

So, the report discussed has revealed the importance of the focus on those key vulnerabilities, and from that point of view we welcome the report. Much needs to be done. And in the cases we have seen this week some issues related to crises in other countries. As I said before, Latin America has provided many of those ones. But we continue working. And in the way the international community provides that framework through organizations like the IMF, we can continue looking for a solution on what we can do, what can be done to prevent those crises. It's a better medicine to prevent than to cure. It's a better medicine to anticipate than to go into the resolution. The pains associated with the resolution and the social costs and political costs are very high. So, let's work in the surveillance. And congratulations to the IMF for the good objective report. Thank you.

4. Presentation by Dr. Miranda Goeltom

**Professor & Senior Research Associate
University of Indonesia**

MODERATOR : Thank you very much, Mr. Medina-López. Now, our second panelist is Ms. Miranda Goeltom. She is now Professor of Economics at the University of Indonesia, but she was Deputy Governor of Central Bank of Indonesia during the period of crisis and played a key role in the management of the crisis. Thank you, Miranda.

MIRANDA GOELTOM : Thank you, Toyoo. Good morning, ladies and gentlemen. It's a pleasure for me to be here in front of this very distinguished speakers and discussants and attendants. I think we all know that the financial crises that engulfed in the region in 1997 crystallized the large number of problems and deficiencies that blocked our regional economies, and Indonesia is one of those that have severely been affected by the crises.

I think I would like to support the view of Mr. López that while it is an experience for Indonesia, unlike Brazil or other Latin American countries, who have been having better experiences in engaging with capital account crises, it is true that for Indonesia we need some help in resolving the problem. I think the fact that there is now an Independent Evaluation Office on the IMF role is most welcome. I will try to figure out a little bit on the situation in Indonesia, the problems that we are facing, the program with the IMF, and last but not least, of course, some critiques on the evaluation.

As one of the Asian tigers the Indonesian economy until 1996 was marked by an annual real GDP growth over 7 percent during the previous two decades, and that was mainly due to very rapid growth of private

investment. Inflation was relatively low, below 10 percent, and export growth rose suddenly. On the other hand, the surplus in overall fiscal balance in 1992 due to oil money was utilized to prepay a huge amount of foreign debt, resulting in a total of external debt decline to below 50 percent of GDP with debts service ratio around 30 percent, one of the lowest in the region.

At the time before the crisis, the exchange rate system in Indonesia was more similar to the crawling peg regime, and this had undoubtedly created the sense of security to the Indonesian private sectors and banks to borrow abroad. So in a relative nonexistence of bond market and long-term yield benchmark, no wonder there were rapid increases in unhedged private foreign debt, while this had supported capital inflow. This capital inflow had supported the private investment growth ; it had also created vulnerability in the country.

On the other hand, banking system was quite fragile, whereby the rapid increase in bank lending by more than 240 banks existing at the time was not covered with enforceable prudential regulation, which had created a moral hazard problem. In fact, before the crisis, some of the insolvent banks were receiving subsidized loans provided by the central bank, and in fact the problem of potential high non-performing loans and large exposure to property loans had never been resolved properly, partly due to the weaknesses of supervisory role of the central bank but mostly because of the political involvement and very strong non-independence of the central bank. Even though, even before the crisis, the central bank had initiated a number of reforms such as merging private banks with some seven state banks to follow increasing the capital adequacy ratio. I think it was too little and too late. On the other hand, the land-seeking behavior of the well-connected businessmen and the highly leveraged corporate balance sheets had also worsened the situation, in particular where corporate governance was not in place.

The political situation at the time was as such, and indeed exemplified the powerless banks in Indonesia and other ministries when it comes to implementing prudential steps to the closely connected group of the President. So, with that background, it is not a surprise actually that the economic turmoil, which was triggered by contagion from the Thailand crisis, had brought a deep recession and contraction to the economy. High inflation that we had never seen before, high unemployment, and a sharp drop in the rupiah values were the scene of the time.

Prior to approaching the IMF, the Indonesian authorities had actually taken some steps to respond to the crises, such as floating the currency in August 1998 after the widening of the band from 4 percent to 8 percent and to 12 percent was no longer seen sustainable. Furthermore, in September, a Presidential decree was issued to cut public spending by postponing big low productivity infrastructure projects. Bank of Indonesia also responded by increasing SBI interest rate to 28 percent from 11 percent, followed by various measures introduced by the central bank to prevent deterioration of NPLs.

However, as we have seen in many publications, the pressures on rupiah had been increasingly dangerous, more and more dangerous, because massive capital outflow and loss of confidence could not be really tackled by government measures. And therefore, in November 1997 the Government decided to seek support from the IMF, and in my experience, at this stage the assumption of the package and the program of the IMF to respond to the crisis, was based on an assumption of contagion which was going to be short-lived. No wonder, because their macroeconomic indicators of Indonesia were very good at the time. Why I think it's a very short-lived contagion effect type of program response ; because the growth assumption was overly optimistic. Inflation was rather low and did not incorporate fundamental

weaknesses in the banking sector, fundamental weaknesses in the governance, both corporate and public governance, and fundamental weaknesses in the capacity of the authorities to implement any prudential steps.

The initial program that was introduced by the IMF in November 1997 was including 16 bank closures, and at the time it was only accompanied by a partial deposit guarantee. This is to my view not the main issue of the background. Yes, partial deposit guarantee was not sufficient, but the fact that was challenged by the power, the son of the President on the bank closure, the reversal of the already postponed power projects, had essentially further deteriorated public confidence. This became very important because there were already some questions in the mind of the market whether the government was committed to the program. And when in January 6, 1998 the President announced the draft budget with zero fiscal deficits and very low inflation rate, the market was very confused, and that had created an unnecessary weakening of rupiah.

In response the IMF, in the second letter of intent in mid-January 1998, tried to put and focus more on structural conditionality assuming that it might restore confidence. Unfortunately, as I have mentioned before, the main problem in Indonesia was not the balance of payments of the capital account crisis alone, and it was not something that had happened in Indonesia for a long time. Only because of the crisis, there was a huge capital account, but the banking sector problem was not fully addressed at the time. There were no specific measures to address the problem despite the fact that bank loan had continued to accelerate. Only after the LOI was announced, there was a partial measure introduced in late January in the form of blanket guarantee scheme and establishing an Indonesian bank-restructuring agency.

In short, the initial program of the IMF in Indonesia had created a

deterioration in confidence rather than improving the confidence, because the public and the market saw that there were no commitments, general commitments from the authorities and the political power. Some authorities were pro of the structural conditionality because in the past it was very difficult for the authorities to convince the President that it was needed. Some were against, and of course this had created a very odd situation for the authorities who were running the policy. The political situation had become worse and worse, and as we all know, there was a social and political upheaval in May. President Suharto was then replaced by Habibbi. Economic situation had worsened considerably because the disposition map had been badly damaged and economic activities were practically disrupted. As business confidence was destroyed, exchange rate had continued to weaken, and inflation pressures were much stronger than initially projected.

One of the untouched things in the initial program is the issue of foreign debt restructuring. After the November crisis we have seen that the foreign indebtedness of the banking system caused harm in trade financing, dropped in import capacity, and this had been made worse by the fact that there was no sufficient data and information on the amount of the short-term debt, which was very under-estimated. So, with that view I think it's very clear that another letter of intent, from time to time, will need to be done because the previous LOI could not be met and there has to be some adjustment made.

In my experience, there are two things that were happening in 1998 that I can share with the audience here. One is the fact that only in April 1998 there was some capacity to tighten the monetary situation, and monetary control was in place, but the initial program of monetary tightening did not take into account the fact that the Indonesian Government was not having any experience whatsoever to engage in automatic stabilizers program. Indonesia, for so many years and for so many decades, had never engaged in a deficit

design to counter any contractions in the economy. And therefore, I think the design at that time was overly too tight monetary, over-all demand tightening, because the monetary policy was tightened so much and the fiscal deficit could not be achieved. For example, even though in April or in June, I think, the fiscal deficit was revised to 10 percent of GDP, which was very large, but in reality, it was only 2 point something percent of fiscal deficit. That had shown that the inflexibility on the monetary side and the policy of the IMF to keep on tightening on the monetary side, while the fiscal side could not play its role to stimulate economy, had created contractions of the economy to almost 14 percent in 1998.

The second lesson in 1998 that I have seen as very important is the fact that information was not sufficiently available on debt, on corporate situation and leverage, and also on the banking situation. So with that view, it's no wonder that we have to be able to see and take some lessons of what needs to be done in the crisis and what needs to be followed up after the crisis. In my view there are several positive results in our program with the IMF, of course, because every time there is an IMF review, the market saw to it, and the investors usually sought some directions for taking actions. In fact, it had provided the government a sheer approval for its policy framework in addressing the crisis.

I think another positive result is that it has established a coherent vision concerning comprehensive strategy needed to be taken in the process of recovery. It has also contributed to building discipline in the implementation of sound macroeconomic policy. LOI, I think, functioned as a tool to discipline the institutions in implementing their activities. Also another positive issue is that the IMF endorsements for fund disbursement have become prerequisites for other international donors.

But as I have mentioned before, there are also many weaknesses in the IMF program. First of all, in all programs it seems that the approaches to the real microeconomic issues were late. Only after a certain period of pressures on the banking sector, for example, a comprehensive strategy to restructure the banking sector was put in the program.

Secondly, I would think the IMF policies tend to be similar for all countries. As I have mentioned before, the different characteristics of Indonesia in experiencing how to respond to a crisis and how in running a contraction policy in a monetary side complemented by expansionary policy on the fiscal side were not really taken into account.

Thirdly, there was some failure to anticipate the political and social response to very detailed restructuring programs, and the lack of timely comprehensive banking restructuring and agency, and the lack of the capacity to address the issue of deficiencies in the financial sector had created and exacerbated the crisis.

I think these are the major things that I can contribute, but let me give one very open view on the IEO's view on Indonesia's problem. I fully agree that we overlooked the potential vulnerability that came from the huge unhedged private foreign debt. I agree that we overlooked the potential vulnerabilities of the banking weaknesses on the market confidence. But my question is the Evaluation Office put so much focus on corruption and cronyism, and if it is defined as abuse of public power for private benefits, I think one would understand that addressing this issue is not an easy thing and can't be done in a very short time. The bad public governance and corporate governance in Indonesia was a product of very long time situation. So I don't believe that even if this is being incorporated in the program, like the structural, the very detailed restructuring of the industrial sector can eliminate

corruption in a while, in a very short time. In a country where there is low wage, in a country where the role of state is often carried out through the use of many rules and regulations, licenses, permits, in a country where the quality of bureaucracy is very very weak, in a country where penalty system is not working, in a country where institutional control, while it plays an important role, factor, but the political situation doesn't allow supervisors to effectively implement the regulation, in a country where transparency of rules, laws and processes creates a fertile ground for corruptions, and in a country where examples by leadership is nonexistent, how could the Office think that addressing the corruption and cronyism could be simplified in the form of heavy structural restructuring program? I think it could even create resistance from the political power, and it could create an unnecessary response from the market and a further loss of confidence.

So, to complete my remarks, I would congratulate the Office for the very good evaluation, but I think there are also many very sensitive wordings and issues that need to be addressed more properly. Thank you very much.

5. Presentation by Mr. Il SaKong

Chairman and CEO of Institute for Global Economics, Korea

MODERATOR : Thank you very much, Miranda. Our next speaker is Mr. Il SaKong. He was, as you know, Former Finance Minister of the Republic of Korea. Now he is Chairman and the CEO of the Institute for Global Economics, Korea. SaKong.

IL SAKONG : Thank you, Toyoo. Good morning, ladies and gentlemen. I would like to begin by thanking the Independent Evaluation Office of the IMF and the IIMA for inviting me to this symposium. I would also like to commend the Independent Evaluation Office of the IMF for producing an excellent evaluation report, which I am sure will contribute greatly toward redefining the role of the IMF and helping prevent and better resolve the future financial crises.

In fact, it is long overdue, in my view, for the global community to critically evaluate and redefine not only the role of the IMF but also the existing international financial architecture as a whole. As you know, the basic institutional framework of the existing international financial architecture was established almost sixty years ago when the international financial environment was so different. Today we live in a financially ever more globalized world, and so the existing international financial architecture, including the IMF, is to a large extent outmoded. In this regard, the IMF's self-evaluation of its role itself is a highly meaningful endeavor. I would commend this effort itself, and I congratulate for a very well balanced report produced by the Independent Office.

Well, I was asked by the Organizers of this symposium to share my

views on the role of the IMF supported programs during the recent economic crises and the lessons learned from the experience. Of course, my view will be primarily based on the Korean experience of the recent crises. To do so, let me first say in a few words, on the courses of the Korean financial crises, which would help, I suppose, discuss the role of the IMF supported program for Korea and the lessons to be learned from the experience.

Although the Korean financial crisis started with the contagion of the financial crises in neighboring Asian economies but the root causes were, I must say, homegrown. The Korean economy had been accumulating structural problems in the course of its rapid industrialization. Since the government-led industrialization strategies were primarily based on financial sector repression and a picking-the-winners type of industrial policy, the financial sector inevitably became weak and underdeveloped. These financial institutions which were plagued with the moral hazard of automatically being bailed out by the government whenever they ran into, financial trouble, naturally had a tendency to have over-exposure to risks without proper hedging and certainly lacked the necessary capability of credit analysis.

Furthermore, in the absence of proper supervisory and regulatory infrastructure in place, the Korean Government's misguided policy of allowing short-term borrowings, actually encouraging short-term borrowings while still restricting the long-term borrowings including in-coming foreign direct investment, encouraged financial institutions to have term structure mismatches of external borrowing and domestic lending.

On the other hand, these financial institutions in turn encouraged, and in fact promoted, the Korean firms, especially big chaebols, with the proven business track records to over-extend themselves with the weak financial structures ; too-big-to-fail syndrome certainly affected both financial

institutions and big conglomerates, that is, chaebols. Undoubtedly, the Korean economy had to deal with these structural problems to remain competitive in the Asian globalization with steeper global competition regardless of the crises.

Well, with this background, let's turn to the role of the IMF. With regard to the pre-crisis surveillance of the IMF, as the evaluation report rightly admits, the IMF, as most of us did, failed adequately to appreciate the fact that weak balance sheets composed substantial macroeconomic risks, even when most macroeconomic indicators suggested no obvious major problems. At the same time, the IMF did not fully recognize the vulnerabilities were created by the wrongly sequenced capital account liberalization.

With these backgrounds and the surveillance aspect of the IMF program, let me now turn to the role of the IMF supported program itself and the possible lessons to be learned from Korean experience. If you look at the IMF's program for Korea, there are two components in the conditionalities, broadly speaking. One has to do with constraints on the managing macroeconomy, and the other one has to do with structural adjustments.

Now, with regard to the first component, and that is the constraints on the macroeconomic management, there have been various criticisms against IMF's conditionalities, particularly the IMF's request at keeping tight monetary policy, which entailed a very high real interest rate, particularly since most Korean firms were over-leveraged. I personally think that since Korea had a twin crisis, that's the banking crisis, and at the same time the foreign exchange crisis, keeping interest rate high was inevitable. The real question is how high is high enough, how long is long enough, to keep the interest rate high. So there are, in my view, rooms for criticism and discussions, but broadly speaking, the high interest rate policy itself and the

conditionality itself was inevitable.

And also, as the report pointed out, in my recollection, the IMF was very flexible actually in reversing its original position. But, of course, many Korean firms maybe to some extent unduly suffered. But it changed its position not in over-delayed time.

The other criticism is with regard to the tight fiscal policies — because the criticism was that tightening the fiscal policy was not really necessary for Korea in restoring confidence. But again on this point, the IMF was fortunately flexible enough to reverse the position. I recall that at the very beginning of the program the IMF said that Korea should have some small positive fiscal surplus or at least the nobalanced budget. Later on it went down to 0.2 percent, and then went down all the way down to minus 7 percent or so. So they just changed it.

So, on this macroeconomic side conditionality, there is some room for criticism and some for the critical evaluation. But in my view broadly speaking, the direction was not really seriously damaging the Korean economic potential.

Now, how about the conditionality of the structural reform? As I previously indicated, Korea needed reform measures to improve its international competitiveness and its growth potential even before the crisis occurred. In other words, the Korean reform measures were long overdue, considering changed international economic environments. Picking the winner's type of industrialization strategies, the government-led development strategies worked okay under the different international economic environment, which existed particularly in 1960s and 1970s. The global economic environment had changed, but Korea was not flexible enough to

adapt to this changed international environment. So, the change and reforms were long overdue. So, if you look at it from this perspective, the crisis is the best time to implement the necessary reforms.

We are right in Japan, Korea, and China in the same characteristics for the crisis. Crisis provides both opportunities and challenges. This is the best time to implement necessary reforms. In a way the crisis was a blessing in disguise, I can say at hindsight. With IMF's conditionalities on the structural adjustments, I suppose the Korean government which was willing — this is important, which had the ownership of reform — could take advantage of the conditionalities.

In that regard I welcome really the structural reform conditionalities. Because these conditionalities depoliticized very, very politically sensitive issues. Chaebols or labors under normal conditions are very difficult for the government and politicians to tackle with. So, in this sense, I think the IMF structural conditionalities were the positive thing.

However, in this regard, the report pointed out that the quick restoration of confidence being the major objective of the IMF rescue program, the critical test of a particular measure should involve whether or not it helps to restore confidence. Therefore the report recommends that a crisis should not be used as an opportunity — let me quote now — “to force long standing reforms, however desirable they may be, in areas that are not critical to the restoration of the crisis.” I think this statement is too strong and I would give the reason why this statement should be or maybe rewritten or may be reconsidered. Because of course if the country does not have willingness and ownership, wouldn't the country run into a trouble in the future? Don't you think that investors will know that? So I think even the test of whether the structural conditionality would contribute to restoring confidence. Actually it may pass the test, and actually I didn't disagree with many recommendations

included in the report, but this statement in my view is a little bit too strong.

Of course, here as again the report rightly pointed out, in designing the conditionalities I think the IMF should work much closely with other competent organizations such as the World Bank, ADB and other development-oriented international organizations and financial institutions. In this regard actually as part of strengthening the international financial architecture, today's important international financial institutions should find the ways to cooperate and collaborate in a much better way, particularly the IMF and the World Bank. I would emphasize that.

In fact, the Korean currency crisis is usually described in journalistic terms in Korea as the IMF crisis. When they say that it was the IMF crisis, I don't think they really say that IMF caused the crisis. But I think they feel that some of the pains and hardships they have to go through when the government implement the structural adjustments may have to do with the IMF conditionalities. If that is the case, in the political economy context, I think it is a good thing. Right? From the government point of view which is willing to implement the reform, the IMF does not have to run for presidency in those countries. I don't think you really need to be popular, but, as long as you do the right job, that is not only good for the country but also for the rest of the world. So, the IMF should have, in my view, the proper structural adjustment programs, of course very closely worked out with the competent institutions.

If I was asked to give a grade to the IMF program for Korea, really I would give at least B+, maybe A-. Of course I will give a much lower grade for the Indonesian program. But for Korea actually I think the IMF did a very good job. Of course, I am not here to defend the IMF, but it is my fair and objective evaluation.

Of course, the IMF program started out with the under-financed as pointed out in the report, and with the very ambiguous terms of reference for the so-called second-line of defense. So, the IMF failed in restoring the market confidence immediately after the rescue loan provision. But the turning point for restoring confidence in the market for Korea came in December 24 Christmas day when we had the roll-over agreement with private banks.

Actually this leads to the issue of so called PSI, Private Sector Involvement. In this regard the recent IMF initiative in introducing some private sector involvement mechanism, particularly for sovereign debts, I would really welcome the initiative. I really would like to see the IMF play a more systemic and more concrete role and active role in implementing private sector involvement

I think the fair burden sharing should be the role and we have to be concerned about the so-called lenders' moral hazard problem. And by having a fair-burden sharing ex ante, I think it will help establishing the global financial stability.

Now, what are the important lessons? Of course, some of the lessons I already implied when I talked about some of the conditionalities. So, these lessons have very important policy implications, not only for the national government level but also regional and global community levels. For example, the first important lesson we learned from the capital account crisis was that strong macroeconomic fundamentals, such as high savings and low inflation and the fiscal prudence, are not enough to prevent a nation's financial crisis. The capital account crisis highlighted the importance of institutional factors such as the rule of law, transparency, and good governance, etc. to prevent such a crisis. Again in this regard we learn that

prudent supervision and regulation of financial institutions are so important. In fact, before the Asian financial crisis, when I was in the government, for example, I was engaged in negotiations with the US government and dealt with the IMF. At that time you didn't hear the word "sequence" for example. There was always a kind of big bang type of approach. It is very important to have a prudent and regulatory infrastructure in place. It is very important to have your financial sector strengthened before you go into step by step the external account liberalization. But before we had the Asian financial crisis, it was mostly the big bang type of push rather than any gradual approach. Of course, sometimes the gradual approach was used as a kind of keeping status quo, not to have reforms. But as long as they are willing, then I think the global community should allow to have very well sequenced reform measures.

Another thing is that one important lesson we learned from the Asian financial crisis was that the short-term capital flows could be very, very volatile in this Asia financial globalization. And the small open economy, no matter how sound they are, can be very, very adversely affected. That is why Paul Volker once likened small open economy as South Pacific canoes, while the bigger economy as USA a great liner in the deep sea of liquid capital. While the little ripple may not affect the great liner like USA, it may capsize the sturdiest canoes, South Pacific canoes. What it means is that at the national level each government should do its own best to make its own economy soundest and make the canoe sturdiest. But at the same time no matter how sturdy and how sound these economies are, still these economies are subject to vulnerabilities. Therefore, the global community and regional community should do something about this. In my view I hope even the IMF should encourage and actually actively participate in helping small open economies and designing some kind of temporary control measures a la Chilean scheme or even Malaysian scheme, of course on a temporary basis.

Because you have to deal with this, unless the global community can implement Tobin tax or something, which may be considered infeasible, then I suppose the things should be done at the national level and at the same time at the regional level.

That leads me to the last point on the regional economic cooperation, because the global economy needs public goods, that is the financial stability. Without that the global economy cannot grow or prosper on a sustained base.

The problem is that the global economy is in shortage of public goods supply, because the global community is not willing to provide sufficient public goods. The gap should be filled in my view by the regional level cooperation. The regional level cooperation — actually after Asian financial crisis, we had Chiang Mai initiative. Mr. Sakakibara in 1997 proposed creation of Asian Monetary Fund. Why not Asian Monetary Fund? If the name is not good enough, maybe we change the name, but I think the regional facility is a good thing. I always take analogy of a fire-fighting squad. If you are in a village where you have village firefighters, but these firefighters have limited resources and capabilities, then neighbors get together and they should have some fire-fighting arrangements, which is good, isn't it? Because that will not only prevent but also put the fire under control much better — of course, as long as the village firefighters don't throw gasoline into fires. So that comes to the conditionality. I think, as long as the mode of operation is consistent with the multilateralism, then I think it is a good thing. So the global community should look at these more positive terms rather than negative terms.

Well, since I spent so much of time, I just want to say that it is a very good thing for the IMF to have this evaluation, but I think this is not enough. The global community particularly G7 should be very serious about reforming the existing international financial architecture. The Bretton Woods

system was established in 1944. Of course the fixed exchange rate regime is gone but the basic institutional infrastructure including the IMF was created then, but today's environment is very different. So, I would like to see that the global community seriously looks at reforming the international financial architecture. In my view there are three critical areas.

- 1) First, the exchange rate regime area at the global level and the country level,
- 2) The second, the short term capital flow area, and
- 3) The third area is the PSI area.

I think we should be really serious about that. Then on this role of the IMF — well, I hope I come back later on during the Q&A session. So, I will stop here. Thank you very much.

6. Presentation by Mr. Eisuke Sakakibara

Professor of Keio University

MODERATOR : Thank you very much, Il SaKong. We have listened to the very candid and productive remarks from affected countries. As you know, Japan was also very much involved and active in the management of the aftermath of the crisis. We have Professor Sakakibara from Keio University who was the Vice Minister of Finance for International Affairs at the time when the crisis hit the region.

SAKAKIBARA : Mr. Gyohten gave me an option either to speak in English or Japanese. But since the majority of the audience is Japanese, I would speak in Japanese. But for the benefit of non-Japanese audience, I would conduct debates in English. (*Following is the interpreted version of his speech*)

We have seen this IEO report and we have also seen the different reform measures of the IMF recently and we appreciate those improvements. With regard to the IEO report, mostly I endorse or support the content of the report. However, taking that into account I still have to say something with regard to the current system of the IMF or international financial architecture.

With regard to the current account crisis, the current system can cope with it but with regard to the capital account crisis it is not ready to do it. So, it only started this way to improve it and is on the process. So, the Asian crisis is a typical case of that defect. With regard to the capital account crisis the most important thing is how you can restore the confidence. How you deal with the market is the most critical thing.

With regard to confidence the structural reform is also important. How do you deal with the structural reform? That is another important issue. However, in 1997, the IMF didn't have the expertise nor the experience to do that. The expertise they had was the macroeconomic expertise basically dealing and focusing only on the current account crisis. That was the readiness they had in 1997. That was the expertise they had. However, with regard to the new kind of crisis, a new type of world financial market dealings and situations the expertise or the experience was very limited for the IMF. That was the fact. For example, with regard to the restoration of market confidence, in the Indonesian and Korean cases and the other cases as well, the IMF actually recommended to raise the interest rate and shift their exchange regime to floating. But when the crisis was already emerging, or during the crisis, shifting to the floating market, I think, is the worst thing for the confidence. Because speculative things will occur like a storm and that was really occurring. If you announce to shift to floating, if I were a speculator it is clear what the speculators would do. So, that was clearly a wrong action.

As I earlier mentioned, raising the interest rate would be good for normal conditions to maintain the exchange rate. However, in the crisis situation once it started, raising the interest rates is really not so positive. To what extent their interest rate should be raised or not depends upon each case. Maybe actually the monetary relaxation would have been necessary. So maybe the judgment at that time was wrong.

Another point, which is not totally the responsibility of the IMF, is the PSI, private sector involvement. PSI is very important and so crucial. As Mr. SaKong mentioned, in case of Korea, its success was a relative case. But Indonesia failed. The major difference is that on 24th of December 1997 I think the private sector involvement arrangement existed in Korea and thus it

became a success in Korea, while it wasn't in Indonesia. G7 nations actually endorsed it in cooperation with the IMF. So, G7 countries actually emphasized the private sector involvement. They had the tough position upon the private sector, saying that without their cooperation, the World Bank and the IMF wouldn't pay money, so there will be a default. So, actually we pressured upon the bankers. Larry Summers has also mentioned the same thing. Germans also mentioned the same thing. Without your cooperation the situation would become default, which would be a tough position. Then PSI became possible, and then it actually helped the Korean side to do this structural reform. In other words, the success of the Korean policy occurred. But after that PSI didn't really advance which private sector's involvement is really needed. Otherwise the typical capital crisis cannot be solved fundamentally. It is not the IMF's responsibility but is the major challenge for us in the future.

What about the structural reform? Korea and Indonesia had the major difference. In Korea they accepted the structural reform but they had the readiness. They had the new regime administration. Kim Dae Jung was elected right before this crisis. He was already elected and he had the major change of policy and administration. So, they were ready to accept the structural reform in Korea. But Indonesia was not ready. The President hardly had any intention to do the structural reform. So, with regard to the structural reform readiness, if the country is ready to do that, then the IMF can work with the administration and it is desirable to do that and promote it. But if the country is not at all ready to accept the structural reform, what can you do? In that case, I think the political interference should not be done by the IMF. It is not something the IMF should be involved.

In the case of Indonesia, of course, when we visited Indonesia, small packages were something Japan requested. In other words, structural reform

was not something to be endorsed or forced, but rather some kind of small package things like intervention in the currency markets were to be done. The IMF, however, did not agree to the small package. It just enforced the big package like distribution ; even livelihood aid was to be cut by the IMF. It was quite unrealistic proposal or recommendation by the IMF. As a result, the administration actually collapsed. Was it good or bad? That was just another matter. It was not the matter to be decided by the IMF. The IMF is a technocrat organization, so it shouldn't be interfering in politics. But as a result, it involved in the policy and it actually collapsed the Indonesian regime. So, it was outside the jurisdiction or mandate of the IMF. The recipient country should be ready to have the structural reform. Otherwise, the IMF should not recommend any structural reform of that sort.

When I talk of those things, I will be running out of time and I have to really stop. Well then, what are the lessons we learned or should learn?

One thing I want to say to the IMF — the current IMF organization or the way of thinking or the way they make decisions actually too dependent upon the macroeconomic consideration and is biased to that way. It is the sort of like a Chicago-based discipline over macroeconomics is overemphasized in the IMF, which is a problem of the Chicago School. That is why I think its decisions become dogmatic. Overemphasis or dependence on macroeconomics should be lowered in the IMF.

Another thing is that they should be more serious to carry out the area studies at least for Asia or Latin America. When you dispatch missions, a half of the mission members should be able to speak the local language or should have expertise and understanding of political situations of the local recipient countries. Their culture, history, and political background should be understood by the IMF mission experts. Otherwise, they cannot come to a

good recommendation for the structural reform. So, that is my recommendation to the IMF.

Another thing — I think you have already initiated but you have to understand the market. The experts have to understand the market or the financial system. It is not the macroeconomics understanding. It is a different understanding. Those people have to be now recruited in the IMF staff.

Another point is the cooperation with the private sector. You have already launched it. You have to have a good coordination with the private sector. That should be given due consideration. The IMF might be likely to do but the Wall Street might refuse it. I don't know. The PSI has not really been promoted, maybe it is due to the Wall Street or the private sector responsibility that PSI is not promoted. So, it is not only the responsibility of the IMF, but any way I think the major reform of the IMF system or organization is necessary. Accordingly, the organization should be really changed.

This IEO is the first step to do that change. This recommendation is very valuable in that sense. I would like to see this as an opportunity or the triggering point for the change in the future. So, the IMF and each national organization should be really reformed to suit themselves to the new changing era, a new world of the financial system. So this can really improve the organization. I hope you continue this effort.

I think I ran out of time, so I would like to stop now.

7. Presentation by Mr. Haruhiko Kuroda

Special Advisor to the Cabinet

MODERATOR : Thank you, Prof. Sakakibara. Last but not the least, this is not really the concluding remarks, but I would like to invite Mr. Haruhiko Kuroda, Special Advisor to the Cabinet to speak. He was also serving as the Vice Minister of Finance for International Affairs, and currently he is serving for Koizumi Administration, as a senior advisor in the areas of international financial and monetary affairs — that is what everybody believes. Including that perspective I hope Mr. Kuroda will speak to us. (*Following is the version interpreted from Japanese*)

KURODA : The IEO was established as an organization out of the criticisms vis-à-vis the IMF's efforts or response with Asian currency crisis. And it has currently announced the evaluation report analyzing the IMF response to crisis in Indonesia, Korea, and Brazil. This in itself I think is very significant and meaningful. As one who was involved in the Asian currency crisis and establishment of the IEO, I do have a very deep emotion about that.

The report itself is very comprehensive and well balanced. I can more or less endorse the outcome of the evaluation. The theme challenged was indeed very difficult and serious efforts were made in coming up with the balanced report, and I would like to express my sincere respect to both Mr. Ahluwalia and Mr. Takagi for formulating the outstanding report.

Many views have been presented by other panelists already. Therefore, I would like to make brief comments on Indonesia, Korea and Brazil on each of these cases.

First of all with respect to Indonesia, as was pointed out in the report, fiscal tightening was not necessary and structural conditionality I believe was excessive. So, I endorse the view reflected in the report. The actual adverse impact on the Indonesian economy was far bigger than what have been mentioned in the report. For example, take fiscal tightening at this juncture. Mild tightening was conducted but that did not produce any impact, according to the report. But in reality, at a time when the policy should be relaxed, it was actually tightened. The gap between the two was indeed very massive. When it comes to the structural conditionality, it included many items irrelevant to the resolution of the crisis, and therefore because of that it had served as disrupting or weakening the market confidence.

Secondly with respect to Korea, including the so-called second line of defense, I do not believe that the program was under-financed in that second line of defense. However, the problem lied in that fact that the United States was less forthcoming in invoking the second line of defense. Japan and other countries advocated the usage and invocation of the second line of defense, which the United States adamantly rejected.

Lastly with respect to Brazil, it was quite clear and certain the problems lied with the exchange rate regime. On this particular point Japan clearly indicated that Japan could not go along and support the idea of maintaining crawling peg. So, Japan maintained reservation. However, Japan accepted the IMF support and also Japan underlined on the bilateral basis extending support to Brazil. Those I believe were the appropriate actions.

Last but not least, the evaluation report has made six recommendations for improvement. All these recommendations I believe are more or less appropriate. In the future years, I hope that those recommendations be actually implemented by the IMF. But if I may just venture to refer one

element, which is not mentioned in the report, that is, at the time of Asian currency crisis, the size of the IMF quota of the Asian countries was too small. This small size of the quota caused the small support program extended by the IMF. At the same time this is one of the reasons that views and opinions of the Asian countries were not adequately reflected in the Executive Board of the IMF and others. This particular aspect remains unchanged without any being corrected. The IMF quota review should have been completed by early this year. However, without any change or modification, that discussion has been finished. All the Asian countries including Japan should strongly require and demand the review of the IMF quota.

Since the time is very short, I would like to complete my comment with this. If later on some questions were raised on items I just mentioned, I would be happy to respond. Thank you very much.

8. Panel Discussion

MODERATOR : Although we are running short of time, I think we should have at least a brief discussion among the panelists.

Takagi-san, you heard other panelists' remarks on the report, so I would like to give you the floor to respond or to make additional comments. Or, Mr. Ahluwalia, whichever...

AHLUWALIA : Thank you, Mr. Gyohten. May I on behalf of Mr. Takagi and myself thank the panelists for what I thought was an excellent discussion, and also for their very kind remarks about the report. There are just one or two points on which I will just take one or two minutes.

I think Prof. Goeltom raised the issue that I think is a very valid issue. When there are governance problems, what is called "cronyism," we shouldn't exaggerate the ease with which this can be overcome. I agree with that. In fact, if you look at the report, our real criticism is not that somehow the Fund should have been able to solve this problem in Indonesia. I think our criticism is that there should have been more awareness of the fact that this phenomenon had contributed to financial weakness in the banking system during the surveillance phase, and that if that had been done to a greater extent, then maybe in the crisis management phase there would have been more attention to the problem of sorting out the difficulty of the weak banks.

The program in November failed because the banking side of the program was not well implemented. I think our view is that better awareness of the seriousness of this problem might have led to more focus on this issue. We completely agree incidentally that the solution does not lie in pushing for a very large number of structural conditionalities as was done in January. It

would have been better to have focused on the banking sector problems early on, and the effort to deal with the cronyism problem by having a multiplicity of conditions in the January program was actually a wrong step.

I think Mr. SaKong, while otherwise complimenting the report, differed on one point. That is that a crisis should not be used to push reforms however useful they may be otherwise. I fully agree with his perception that a crisis is also a moment of opportunity and in a country it may well be the occasion to push for many reforms. The question that we have raised is, “Should those reforms be made part of IMF conditionality?” or “Should the IMF limit itself to those conditionalities that are really relevant for restoring stability?” But certainly within a country I completely agree, and certainly it is true in my own experience when we had a crisis back in India? The country policy makers may well want to use the crisis to bring about long standing reforms. But it is not necessary for those reforms to be made part of IMF conditionality. So, I think we are making that distinction between the two.

I agree with the major points made by Mr. Sakakibara as well as Mr. Kuroda and we will give a lot of thought to some of the questions that have been raised as to how one might go further. Thank you very much.

MODERATOR : Thank you. I think some, at least, panelists may have something they would like to say. Miranda, do you have any comments to add after you listened to Montek’s response?

MIRANDA : Yes, I forgot to mention before that I fully agree that ownership is very important. I think the failure to restore public confidence in Indonesia at the initial stage was due to market disbelief that the government owns the program. I think that issue has been lingering even up to now when

we are about to exit from the IMF program. Some of the very non-IMF views see it was a total failure. And it was a total failure not only due to the fact that some of the needs were not addressed — the needs to focus on the real issue ? but it was also a failure because it did not take into account the political situation. I think that was why — I do agree, as I just mentioned, that you did not mean cronyism and corruption could be addressed with large structural conditionality. But I also want to point out later on some of the wordings that I think have heavily stressed upon only cronyism and corruption as the main source of the whole crisis. Eventually, the crisis was the product of multifaceted problems in the area of corporate governance and public governance. Thank you.

MODERATOR : Thank you. SaKong, don't you have any comments to add or...

SAKONG : I just want to emphasize that the country ownership and willingness to implement reform is the precondition. This is a very important thing. Once you have that, then it will very well work out conditionalities. Of course, I will again emphasize the fact that it is important to have collaboration with the World Bank or ADB. Then, sometimes we really take pressure out of domestic politicians, too. Because they have to go back to their constituents and say, “We cannot step with our existing policy because our option is a moratorium. To avoid this moratorium we have to get this rescue fund and the provider has this kind of conditionalities.” So, in the political economy context, if the country is willing, then I think these conditionalities will work out well, will have a great deal. I think that is why one of the economists in Japan who wrote the column in this newspaper, a weekly journal, said that Japan should invite the IMF just like Korea did. So, I mean when you have this kind of external pressure, if you wisely utilize it, it is good for the country. That is what I emphasize. Of course, you have to

be very sensitive about it.

MODERATOR : Thank you. Any other panelist wishes to make comments? This will be the last chance.

SAKAKIBARA : If I may add, I completely agree with this report that the transparency is the key. Both the IMF and member countries at least need to agree to publish the reports. But not only reports, I would give you one instance where I had a major problem with the IMF intransparency. Apparently between Indonesia and the IMF, there was a side letter about the exchange rate intervention. We demanded that the side letter be disclosed. Because without that side letter we could not have known the whole package of the program, but it was never disclosed to us. Their reasoning is, “Well, Japan is very heavily involved, we have the right to know that.” Their reason was, “If we disclose it to Japan, we have to disclose it to all the members of the board.” “Well, then, why not to all the members of the Board?” Something which is that important cannot be just structured between a limited number of the IMF bureaucrats and government officials of recipient countries. So, I think transparency is very essential in the future reform of the international financial system.

MODERATOR : Medina-López?

MEDINA-LOPES : It is very difficult in the case like the IMF, a very difficult position. You come too strong and you are too strong. You come too weak, you are too weak. So, to find the right way in implementing policy and helping structural reforms is no easy task. It is a quite challenging one. The IMF and IEO have been looking at it very carefully. What is true is that the issues that have been raised of the political ownership and transparency are critical issues for moving ahead with any reform, with any crisis resolution.

We notice that everywhere countries have learned some lessons. Many of the countries are now opting for some strategies in dealing with the potential crisis that might come their way. We have noticed that many countries are building their reserves, they have been shifting to the more flexible exchange rate agreements, and they are tightening their fiscal policies. So, some lessons have been learned. By many ways, the relationship is now from the top to the bottom in the case of the IMF. But it is working at the same level with the countries and trying to monitor to see which are the critical issues and how, working together, they can now address them before they become serious problems.

9. Open Questions and Answers

MODERTOR : Thank you. Kuroda-san? Okay, then for the remaining 10 or 15 minutes, I would like to invite comments or questions from the audience. So, please feel free to raise your hands. You may make your questions either in Japanese or in English. Please identify yourself and indicate to whom you are addressing your questions. So, please, the gentleman over there.

MARTIN SCHULTZ (FUJITSU) : Thank you very much. Martin Schultz, Fujitsu Research Institute, here in Tokyo. I have a question to the authors of the report.

The report mentions very many, very important reforms and proceedings for the IMF, from transparency to having better growth models, more locally adjusted staff, and so forth and so on. But there were also different criticisms from the board, especially from Mr. Il SaKong. Also you mentioned that there are many studies after the Asian crisis, of course, criticizing the heavy lead approaches by the IMF in terms of interest rate policies in the countries, in terms of the difficulties of raising more funds by the IMF during the crisis, protecting foreign investors in the crisis countries.

The question would be : Can we expect that your organization, your office, will go more deeply into these questions as well in the future? Or will you remain more on an auditory board or more technical side of evaluation and criticism or criticizing guideline?

MODERATOR : Takagi-san.

TAKAGI : You addressed that question to me, but judging from the nature of the question, it is probably more appropriate for the Director of the IEO to speak.

AHLUWALIA : Well, that is a good question. Our role is limited to evaluation. The questions you raised will keep coming up in different evaluations. And we will pick them up as they come up in subsequent evaluations, hopefully informed by earlier findings and hopefully informed by comments and criticisms of our own work. But we do not get into the current operational work of the Fund. However, the way the system is structured, our reports go to the Board. The Board looking at these reports takes a view on what the Fund policy should be. The Fund is then guided by whatever the Board decides. So, we don't directly work with management on how to make our report, recommendations, translated into policy. We submit the report to the Board with our recommendations. The Board takes a view, management also takes a view, and then it is really up to management supervised by the Board to implement whatever changes it wants to make. We don't get involved in that directly. That I think is the way to go. I mean otherwise we cannot maintain independence, if we are also involved in negotiating how to make policy changes basically.

MODERATOR : Maybe we can entertain the next question from the floor. Next question. Please that person there.

NISHIZAWA (JAPAN BANK FOR INT'L COOPERATION) : I have a question as to the regional surveillance and, the IMF and IEO members are someone that I want to target my question. Or maybe some other questions are there, and maybe other panelists could also comment to my question.

Regional surveillance is now so important an element. However, can we really have it implemented? I think it requires some ideas to improve this regional surveillance implementation. The IMF, I think, needs to get some idea from outsiders. I hope the IMF will listen to the views of outsiders. You need a system to listen to those outsiders' views. But with regard to your

IEO, what is the specific way that you would like to have a good regional surveillance to collaborate with other organizations? How can you have a good implementable regional surveillance in cooperation with other organizations?

MODERATOR : Any panelist in the IEO members and so forth could respond to this question. Maybe Mr. Takagi could respond first.

TAKAGI : (Since the question was raised in Japanese, I would like to respond in Japanese.) The IEO's objective is to evaluate the IMF's policies and procedures. So, in the next year or two, as the work program is determined by the Director, regional surveillance may well become a subject of evaluation. However, the topic is more likely to be regional surveillance by the IMF, for example, on the EU or some other regional economic groups. What should be the modality of regional surveillance? Can we say something about that or make recommendations? That is the kind of regional surveillance we are considering for the future, although it is not decided yet. On the other hand, regarding what specifically Japan or Asia should do in terms of regional surveillance—which you may have in mind—we are not in a position to comment.

10. Closing Remarks

By Hiroyuki Hino
Director of Regional Office for Asia and the Pacific, IMF

MODERATOR : Any other question from the floor? Additional question from the floor? If not, I would now like to conclude the symposium with this, since there seems to be no further question.

But before officially closing the symposium, representing the Regional Office for Asia and the Pacific of the IMF, I would like to invite Mr. Hino to deliver his closing remarks.

HINO : The IMF's Regional Office for Asia and the Pacific has been indirectly supporting this symposium. I am representing this office and would like to express some words of appreciation.

First to Director Ahluwalia and Mr. Takagi. Thank you very much for agreeing to have this symposium here in Tokyo. It has been a very informative and very useful symposium. Director Ahluwalia knows the IMF from many different angles. In the early 1980s he negotiated a loan program between India and the IMF. He was the central person negotiating on behalf of India with the IMF. I did have personal ties with him in that capacity. So, as a borrower he knows the IMF—how it functions, and what sort of challenges it has.

Subsequently as a representative of India or a representative of developing countries, he made many statements and recommendations in international conferences, ministerial meetings and other fora on the IMF's policies. He has indeed been observing the IMF from many different angles, and from very broad perspectives. Therefore, I believe there cannot be any

person better qualified than Mr. Ahluwalia to serve as the first Director of the International Evaluation Office. We have been indeed very fortunate having him. Mr. Takagi I think is a well-known figure here in Japan without any need for introduction.

Moving on to the panel members, Ms. Miranda, Mr. Il SaKong, and Mr. Medina-López made very well balanced comments and presentations from the perspectives of countries directly affected by the crisis. Prof. Sakakibara certainly met our expectations—he was very candid and frank in his statement. Mr. Kuroda wrapped up all the presentations succinctly, covering all the key issues in a balanced manner.

As the moderator Mr. Gyohten, under your leadership, we were able to have a very productive and efficient symposium. Given the theme, I think we couldn't have any person better qualified to serve as the moderator than Mr. Gyohten. To the Institute for International Monetary Affairs, Mr. Asami, Mr. Haramishi, and Mr. Harada and other staff members, I would like to express my sincere gratitude for their efforts in organizing this symposium. The preparation, I am sure, required enormous work, which had been impeccably completed.

It might sound very self-serving, but the staff of Regional Office for Asia and the Pacific of the IMF made important contributions for this symposium as well. I would be amiss if I didn't mention the fact. Last but not the least, I would like to express my sincere gratitude to each and every one of you who were kind enough to spare your very precious time in participating in this symposium. Owing to your support and cooperation, we were able to have a very meaningful and very informative symposium.

The discussions we have had today, I hope, would help the IMF further

transform and reform itself into an even more transparent organization that would serve all its members effectively in achieving sustainable growth, macroeconomic stability and poverty reduction. Transparency is so important as was mentioned by Prof. Sakakibara. I think the progress that the IMF has made in this regard is now better understood. Listening to the opinions offered from the outside, to use it for the self-improvement is the very important aspect of the reform of the IMF. This I am sure has been well understood.

I personally was very much impressed with the statement made by Mr. SaKong, namely, without true ownership of reform of the country concerned, there cannot be any effective solutions to avoid recurrence of economic crises. This point was also emphasized by Ms. Miranda. Without ownership the market confidence cannot be restored, she said. True, there are many ways where the IMF can make very important contributions and there is room for further improvement. But without true ownership of the country concerned, nothing can function effectively in restoring market confidence or implementing reforms. Prof. Sakakibara talked about offering a small program in cases where the ownership of the country concerned is not enough. Would a small program be an effective solution? I am not quite sure about that.

I believe that many fruitful thoughts for future were suggested during the symposium. Thank you very much.

MODERATOR : Thank you very much. Everybody thanks everybody. And the meeting adjourned very successfully.

APPENDIX

APPENDIX 1



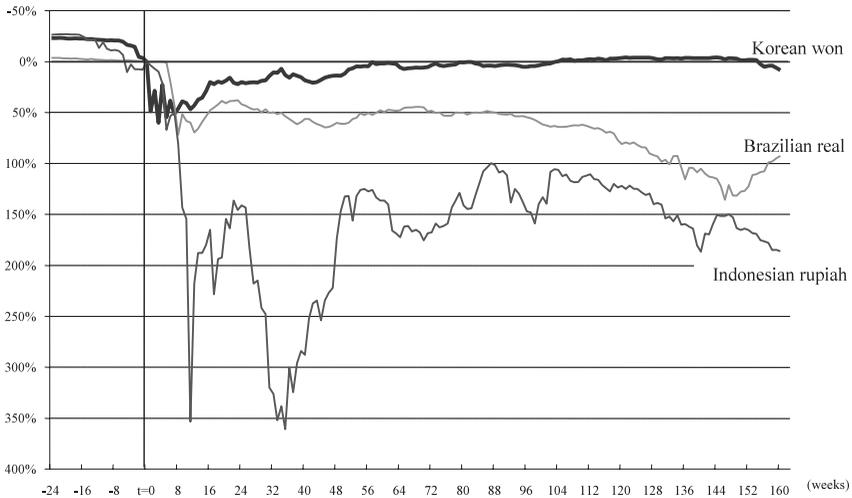
The IMF and Recent Capital Account Crises: Indonesia, Korea, Brazil

Independent Evaluation Office (IEO),
IMF

GDP growth (%)

	1997	1998	1999
Indonesia	4.7	-13.1	0.8
Korea	5.0	-6.7	10.9
Brazil	3.3	0.1	0.8

Exchange Rate Against the U.S. Dollar (Percentage change from the date of program approval)



Indonesia



- Record of strong growth, but also “cronyism” and weak banks.
- July-August 1997: Crawling peg bands widened, then abandoned. Pressure on the rupiah continues.
- November 1997: IMF stand-by arrangement for \$10 bn.
- Bank closures. Central bank creates liquidity. Political crisis.
- January 1998: Detailed structural program signed, but never formally approved.

Indonesia (cont.)

- March 1998: President reelected. New economic team.
- April 1998: Revised program with tighter monetary controls.
- May-June 1998: Political crisis worsens. President resigns.
- August 1998: Financing replaced by \$6.3 bn Enhanced Fund Facility. Slow and uneven stabilization and reform.
- Overall: Severe collapse in growth and rise in poverty.

The IMF and Indonesia

- In pre-crisis surveillance, identified banking sector vulnerabilities, but underestimated severity and macroeconomic impact.
- Political “ownership” of the program and resistance of vested interests underestimated.
- Poor design and implementation of bank restructuring strategy.
- Excessive structural conditionality.

Rep of Korea



- Record of strong growth and macroeconomic stability.
- Economy dominated by large conglomerates, directed investment.
- Extensive short-term foreign-currency borrowing by banks.
- Unprecedented wave of bankruptcies of chaebol in early-mid 1997.
- End-October 1997: Speculative attacks on Hong Kong and Taiwan. Investors take a second look at Korea.
- Capital outflows and a run on the currency by mid-November 1997. BOK deposits hard-currency reserves in banks' overseas branches. Rollovers fall.

Korea (cont.)

- Early December 1997: IMF stand-by arrangement for \$21 billion. \$20 billion as “second line of defense.”
- After a few days, the won goes into free fall and reserves fall sharply.
- Kim Dae-Jung elected president, announces his support for radical reform measures.
- Christmas eve: major creditor banks announce coordinated rollover, willing to negotiate maturity extension.
- The government begins energetically implementing the reform package and cleaning up the banking system.
- 1998: V-shaped recovery.

The IMF and Korea

- Surveillance missed the relevance of uneven financial liberalization.
- Gaps in data: reserves, private debt.
- Uncertain status of the “second line of defense.”
- Crisis coordination role – but with a delay?
- Initial fiscal tightening unnecessary, but quickly reversed.
- Financial sector restructuring ultimately achieved impressive results.

Brazil



- 1994: The Real Plan brings disinflation, but the policy mix led to large fiscal deficits, overvalued exchange rate.
- August-September 1998: Capital outflows after Russia/LTCM.
- December 1998: IMF financing of \$18 bn to support the crawling peg. Pressure on the real continues.
- January 1999: Currency floated.
- March 1999: Revised IMF-supported program, based on inflation targeting. Voluntary rollovers of interbank lines and trade credit.
- Inflation is lower than expected; positive growth.

The IMF and Brazil

- Key vulnerabilities were identified, but downplayed.
- Had little impact on policies pursued by authorities.
- Too concerned about contagion?
- Transition to inflation-targeting managed well.
- Tighter fiscal stance continued.

Some similarities

- Change in market sentiment causes reversal in capital flows.
- “Exceptional” IMF access, supplemented by other sources.
- Initial programs did not restore confidence, but subsequent responses more successful.

Some differences

- Indonesia and Korea had balanced fiscal accounts and a history of low inflation; Brazil did not.
- Indonesia and Korea were “twin crises”; Brazil was not.
- Political commitment was strong in Korea and Brazil (after initial uncertainty), weak in Indonesia.

Pre-crisis surveillance



- Good on macro vulnerabilities.
- Not as good on extent of/implications of:
 - Financial sector balance sheets
 - Corporate balance sheets
 - Governance issues
- Information provision by authorities.
- Impact on policies generally limited.
- IMF as confidential advisor?

Program design: Macro framework

- Projections were too optimistic in Indonesia and Korea; too pessimistic in Brazil.
- In all three cases, this led to weakness in fiscal policy.
- Projections missed currency depreciation, balance sheet effects, implications for private investment.



Program design: fiscal policy

- Indonesia and Korea: Mild tightening initially, soon relaxed.
- Brazil: Strong tightening, but not sufficient to stabilize debt/GDP ratio.





Program design: Monetary policy

- In all three countries, initially tight.
- In Indonesia, monetary base expands rapidly.
- In Korea, gradual easing – too gradual?
- In Brazil, more rapid easing.
- Possible conclusion: high interest rates were not sufficient for stabilizing exchange rate, and can have adverse impact when balance sheets are weak.

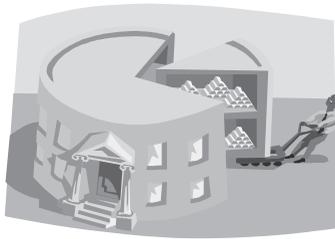
Program design: Financing and Private Sector Involvement (PSI)

- Korea: Ambiguity over “second line of defense” was damaging.
- PSI important for Korea and (to a lesser extent) Brazil. IMF played a role in coordination, information provision.
- Credible program needed for effective voluntary PSI.



Program design: Bank closure and restructuring

- Important in Indonesia, Korea; not Brazil.
- Need a comprehensive and well-communicated strategy.
- Partial vs blanket guarantee?



Program design: Structural conditionality



- Indonesia and (to a lesser extent) Korea: Extensive conditionality.
- The financial ones were probably necessary, the non-financial ones not.
- Brazil: Fewer conditions, mainly fiscal and prudential.

Program design: Communications strategy

- Need to explain the logic and strategy of the program to the public and the markets.
- All three cases: Didn't do so initially.



IMF internal governance

- Lack of candidness. Judgments became less sharp as they went up to Executive Board level.
- Coordination across departments.
- Role of major shareholders.
- Coordination with World Bank, other MDBs.



Recommendation 1. Surveillance should take a stress-testing approach.

- Staff reports itemize the major potential shocks the economy could face.
- Explore their real and financial consequences.
- Discuss response plans with authorities.
- Identify:
 - Information gaps
 - Balance sheet mismatches
 - Political constraints on policy making

Recommendation 2: Improve impact of surveillance, through greater candidness, transparency.

- Presumption of publication of Article IV staff reports, country-related working papers.
- Institutional incentives for candid staff assessments.
- Second opinion? Escalated signaling?

Recommendation 3.

Comprehensive review of program design

- More attention to impact of balance sheet interactions.
- Allow for flexible response.
- Review use of quantitative performance criteria.
- Avoid imposition of reforms that are not critical to crisis resolution.
- Communications strategy.

Recommendation 4: Financing should be sufficient and credible

- Terms for parallel official financing should be clear, ideally subject to the same conditions as IMF financing.
- Terms for involvement of other institutions should be specified at the outset.



Recommendation 5: The IMF should be proactive as a crisis coordinator

- Management should be frank with Board and shareholders about probability of success.
- No political interference in technical judgments of staff.
- Identify circumstances where PSI could be useful, through such means as dialogue with the private sector.

Recommendation 6: Better development and utilization of staff expertise

- Key areas: Country-level expertise, political economy, crisis management.
- Ensure that resources are maintained and ready to respond to crises.
- Review role of resident representatives.
- Protect those who raise uncomfortable issues with authorities.
- Develop critical mass of staff with country experience.

APPENDIX 2

EXECUTIVE SUMMARY (from the IEO Evaluation Report)

1. This report evaluates the role of the IMF in three recent capital account crises, in Indonesia (1997-98), Korea (1997-98), and Brazil (1998-99). These crises have been the subject of extensive external commentary and have also been studied in detail by IMF staff. A number of important lessons have already been learned and corresponding corrective steps taken in the form of revised IMF policies and procedures. Nevertheless, it is appropriate for the Independent Evaluation Office (IEO) to conduct an independent assessment of the role of the IMF in these crises, taking advantage of its unique access to internal IMF documents while also taking note of earlier work where relevant. The evaluation seeks to draw lessons for the IMF, supplementing those that have already surfaced, and also to contribute to transparency by evaluating the internal processes by which important decisions were made.
2. The findings of this evaluation report are subject to three important limitations. First, any evaluation inevitably benefits from hindsight and while this can be an advantage in drawing lessons for the future, much of what we know now may not have been known at the time to those who had to make the relevant decisions, often under extreme pressure. These considerations must be borne in mind in determining accountability. Second, any evaluation implies a comparison with a counterfactual, i.e., what might have happened with alternative policies. This is very difficult to establish rigorously. Third, the behavior of an economy is always subject to uncertainty and the uncertainties are much greater in crisis situations. In the face of uncertainty, a program cannot be judged to represent a mistaken choice *ex ante* just because it failed *ex post*. The relevant criterion is whether the *ex ante* probability of success was high enough.

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3. The report consists of two parts. The main report presents our assessment of the role of the IMF in the three crises and the lessons to be drawn from the experience, with some specific recommendations going beyond the steps already taken. The annexes contain the three country studies that form the basis for our judgments in the main report.

A. Overall Assessment of the Role of the IMF

4. The three country cases studied share several features common to capital account crises ; in each case the crisis was triggered by massive reversal of capital flows, short-term flows played a prominent role, and contagion was an important factor. However, there were also notable differences. The nature of the crisis differed in the three cases, with Indonesia and Korea exemplifying “twin crises” in which the external crisis coincided with a banking crisis. There were also differences in the policy mix advocated, the political environment in which the crisis was managed, and the effectiveness of implementation. All three programs failed in their initially stated objectives, but the subsequent experience under the revised programs was very different. Our overall assessment of the role of the IMF in each of the three crises is as follows :

Indonesia

5. IMF surveillance did identify the vulnerabilities in the banking sector that would later become crucial to the evolution of the crisis, but it underestimated the severity and the potential macroeconomic risks posed by them. In designing its crisis management strategy during October 1997, the IMF misjudged the extent of ownership at the highest political level and underestimated the resistance to reform likely to be posed by vested interests. This underestimation of political constraints was perhaps a reflection of the earlier failure of surveillance in recognizing the
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changing nature of corruption and cronyism.

6. The single greatest cause of the failure of November 1997 program was the lack of a comprehensive bank restructuring strategy, which led to a rapid expansion of liquidity to support weak banks. The resulting loss of monetary control in turn contributed to a weaker exchange rate and greater distress in the corporate sector. The crisis became intensely political, following the illness of the President in early December, making crisis management even more difficult. At this stage, the IMF negotiated a revised program in January 1998, which focused heavily on structural conditionality to signal a clean break with the past. The focus on structural conditionality was based on the assumption that this was necessary to restore confidence. It failed to do so, partly because of visible lack of political commitment to the policies promised and partly because of the failure to address the critical banking and corporate debt problems.
7. The Indonesian crisis was clearly the most severe of the three under review, with GDP declining by 13 percent in 1998 and a large increase in poverty. This devastating outcome cannot be attributed solely to shortcomings on the part of the IMF. The lack of firm implementation of the November program, and especially the reversal of some of the critical steps at a very early stage, eroded market confidence and the situation soon got out of control as political uncertainty increased and riots occurred against the ethnic Chinese community. These exceptional circumstances explain much of the severity of the crisis experienced by Indonesia. However, our evaluation suggests that the IMF's response to the failure was also inadequate in many respects.

Korea

8. In Korea, IMF surveillance failed adequately to identify the risks posed by the uneven pace of capital account liberalization and the extent of
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banking sector weaknesses, owing to the adoption of a conventional approach that focused on macroeconomic variables. There were gaps in the data needed to make a full assessment, though available data on short-term debt and financial market indicators were not fully used. While concerns over Korea's weak banking sector had prompted international banks to review their lending to some Korean institutions even before the onset of the Asian crisis in July 1997, the IMF was optimistic until virtually the last minute.

9. The first Korea program was clearly underfinanced, but this was due primarily to the unwillingness of major shareholder governments either to take concerted action to involve the private sector or to provide the necessary financing upfront to resolve what, of all the three cases, was most clearly a liquidity crisis. When this strategy failed, the major shareholder governments moved quickly to initiate concerted action to involve the private sector—an approach that eventually worked well. It could be argued that the first strategy needed to be tried and proven to have failed before the rollover agreement of December 24 could be secured. The IMF played a useful role as crisis coordinator in drawing attention to the problem and later facilitating information exchange among major governments and helping to set up a monitoring system to ensure compliance.
10. The Korean adjustment process involved a severe downturn, with GDP declining by 6.7 percent in 1998, compared with a forecast of positive growth. However, unlike Indonesia, this was followed by a robust recovery in 1999. The greater than expected downturn reflected the impact of negative balance-sheet effects, which were clearly underestimated. In retrospect, the fiscal tightening in the program was unnecessary, as the IMF staff has itself concluded.

Brazil

11. In Brazil, IMF surveillance was successful in identifying the key vulnerabilities that were at the core of the crisis, in part owing to the fact that they were largely macroeconomic in nature. However, it progressively downplayed the scale of overvaluation, and had little impact in persuading the Brazilian authorities to take sufficient corrective action even in areas where the diagnosis was correct. When Brazil faced intense speculative pressure on its foreign exchange reserves from mid-1998, the IMF reluctantly supported the authorities' preference for maintaining the existing exchange rate regime. However, intense pressure on the real developed in December 1998, and the program soon failed with the collapse of the peg in January 1999.
12. A major justification for defending the exchange rate was that an exit from the peg at that time would have unsettled international financial markets already nervous after the Russian default and the LTCM crisis. With the benefit of hindsight, it can be argued that this concern was overplayed. An earlier exit from the peg, widely perceived to be unsustainable, probably would not have had major systemic effects if it had been made under an IMF-supported program. The hedge provided to the private sector by the government, through the use of foreign exchange reserves and exchange rate-indexed bonds, ensured that the sharp depreciation that followed the floating of the real in January 1999 had little adverse effect on the Brazilian economy. However, this was at the cost of a substantial increase in the stock of public debt, which stored up problems for the future.
13. The revised 1999 program fared fairly well in the short run. Contrary to program expectations of negative growth in 1999, Brazil actually experienced positive growth of 0.8 percent. This was largely because of the healthier state of the banking system, combined with the provision of the hedge, which mitigated balance-sheet effects on the private sector.

The IMF played a useful role in facilitating Brazil's transition to an inflation-targeting monetary regime as well as a more disciplined fiscal policy regime, but in retrospect, fiscal vulnerabilities were not fully eradicated.

B. Pre-crisis Surveillance

14. IMF surveillance was more successful in identifying macroeconomic vulnerabilities than in recognizing and analyzing in depth the risks arising from financial sector and corporate balance-sheet weaknesses and the governance-related problems that contributed to those weaknesses. Insufficient candor and transparency limited the impact of surveillance on policy, even in areas where the diagnosis was broadly accurate.
15. In Indonesia, the IMF did identify banking sector weaknesses as a problem, but surveillance reports underestimated the potential adverse macroeconomic consequences of these weaknesses. Surveillance also paid insufficient attention to the changing nature of corruption and the macroeconomic risks it posed, and surveillance reports were less candid on these issues.
16. In Korea, the IMF failed adequately to recognize the vulnerabilities created by the uneven sequence of capital account liberalization and the risk that a change in investor sentiment could cause a severe drain on foreign exchange reserves. While the crisis also came as a surprise to many other observers, the IMF was slow to catch the rising concerns of international banks over Korea's banking sector problems, which had begun to surface several months before the onset of the full-blown crisis. In retrospect, surveillance proved too sanguine about these growing risks.
17. IMF surveillance effectively diagnosed the major vulnerabilities in Brazil, largely because Brazil's vulnerabilities manifested themselves primarily as macroeconomic phenomena, such as the rising stock of

public debt and real exchange rate appreciation, which were part of the IMF's traditional toolkit.

18. In all three countries, the IMF's role as confidential advisor was not very effective in persuading countries to modify their policies even when key vulnerabilities were identified. The IMF was not provided with much sensitive information required for effective surveillance. While it is difficult to generalize from three cases, or to test the counterfactual concretely, the IMF probably could have been more effective in influencing policy if it had made its analyses public so as to contribute to a wider policy debate.

C. Program Design and Implementation

Macroeconomic framework and projections

19. In all three cases, macroeconomic outcomes turned out to be very different from program projections. In Indonesia and Korea, the initial projections were overly optimistic, leading to a design of macroeconomic policies that turned out to be too tight given the outcome in aggregate demand and output. In contrast, the initial projections for Brazil in 1999 were too pessimistic, which contributed to fiscal adjustment that turned out to be insufficient, in light of that country's adverse public debt dynamics.
 20. Part of this problem arises because macroeconomic projections in an IMF-supported program are necessarily the outcome of negotiation. However, there were also analytical weaknesses since forecasts were not derived from an analytical framework in which the key determinants of output, and their likely behavior during the crisis, could be dealt with adequately. In particular, there was insufficient appreciation of (i) the large currency depreciation which might occur in view of the possibility of multiple equilibria, and (ii) the severe balance-sheet effects that might result. It is inherently difficult to forecast macroeconomic outcomes
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reliably, especially in crisis situations, but these problems could have been reduced if there was a more explicit focus on the key factors affecting aggregate demand, particularly private investment.

21. In light of the considerable uncertainties, a more explicit discussion in program documents of the major risks to the macroeconomic framework, with a clear indication of how policies would respond if the risks materialized, would have been helpful. In practice, subsequent program reviews on Indonesia and Korea did show flexibility, but an upfront recognition of risks would have sent a more transparent signal on the expected stance of policies.

Fiscal policy

22. All three programs involved fiscal tightening. The extent of tightening was mild in Indonesia and Korea, while it was fairly strong in Brazil. In view of output developments, the initial tightening of fiscal policy in Indonesia and Korea was not warranted, and it was in fact relaxed quickly when the extent of output collapse became evident. In any event, in both countries, the initial fiscal tightening was not the cause of the output collapse. This was the result of balance-sheet effects, which were not factored into program design. In Brazil, fiscal tightening was much sharper. This was appropriate because fiscal sustainability was a major issue driving the evolution of the crisis. However, it turned out not be sufficient to achieve the objective of stabilizing, and then reducing, the debt-to-GDP ratio.

Monetary policy

23. The stance of monetary policy in all three countries was initially set tight, with an explicit recognition of the tradeoff between higher interest rates and a weaker exchange rate. However, the experience of the three countries varies and does not provide a definitive answer to the ongoing
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debate on the effectiveness of high interest rates in stabilizing the exchange rate.

24. In Indonesia, the maintenance of tight monetary policy envisaged in the program was simply not implemented, as the monetary base expanded rapidly and real interest rates became increasingly negative during the early months of the program. The assertion by some critics that the tight monetary policy advocated by the IMF was a cause of the output collapse is not warranted for the simple reason that it was not implemented for most of the crisis period. Exchange rate stability returned in March 1998, when the rupiah had sufficiently depreciated and interest rates were raised and monetary control regained.
25. In contrast, Korea implemented the tight monetary policy envisioned in the initial program by raising domestic interest rates and the penalty rate charged to banks for central bank foreign currency advances. These moves were appropriate to defend the currency, but they were not by themselves sufficient to stabilize the exchange rate, because much of the capital outflow was in fact driven by credit considerations rather than yield. It can be argued that real interest rates were kept higher than might have been necessary in early 1998, when the exchange market had stabilized. However, the still uncertain situation understandably called for some caution. Given the contractionary impact of bank restructuring on credit flows, the few months of higher than necessary interest rates could not have been the dominant cause of the recession.
26. In Brazil, the excessive easing of interest rates—over the IMF's objections—may have contributed to the timing, if not the eventuality, of the collapse of the crawling peg. A decisive tightening of monetary policy in March 1999 coincided with the restoration of stability in the foreign exchange market. However, one must be careful about the causality, given the fact that an informal agreement by major international banks to maintain credit lines to Brazil was reached around

the same time. High interest rates did not have a major negative impact on the private sector, because of the sound state of the banking system and the low leverage of the corporate sector, compared with the situations in Asia. Subsequently, the IMF supported Brazil's transition to an inflation-targeting regime, which allowed for price stability and a rapid reduction in interest rates.

Official financing and private sector involvement

27. The size and format of the official financing package were inadequate in Korea and contributed to the failure of the first program. The ambiguity over the availability of US\$20 billion in bilateral assistance pledged as a "second line of defense" in Korea created uncertainty in the market about the ability of the program to meet the country's immediate liquidity needs.
 28. In the other two countries, the programs failed for other reasons. The failure of the initial Indonesian program was due, not to inadequate financing, but to other factors, including non-implementation of the key elements of the program by the authorities and the subsequent explosion of liquidity because of the failure to resolve the banking crisis. Once the program had failed, the crisis became intensely political, leading to a large amount of capital flight by domestic residents, and the sharp depreciation of the rupiah began to create solvency concerns. No reasonable amount of official financing could have restored confidence at that time. In the case of Brazil, the initial program failed because the key policy, namely, that of supporting the crawling peg, was not credible with the markets.
 29. In Korea and Brazil, the IMF's role as crisis coordinator in organizing private sector involvement (PSI) was limited by the unwillingness of major shareholder governments to use non-market instruments to influence the behavior of private sector institutions and concerns that
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such action might precipitate an exodus of capital from emerging markets. However, when a decision was made by the major shareholders to involve the private sector, the IMF played a useful role in facilitating information exchange among major governments and helping to set up systems of monitoring compliance.

30. An earlier attempt to involve the private sector in Korea would have been warranted, but given the initial unwillingness of the IMF's major shareholder governments to take concerted action, there was probably little the IMF could do. The agreement by major international banks to roll over interbank debt on December 24, 1997 was a turning point in the crisis. The success of this approach owed much to the fact that most of the short-term external debt was interbank credit. The Brazil experience in the second program suggests that a program with a high degree of credibility is necessary for the "voluntary" approach to PSI to work. In Indonesia, the IMF provided technical assistance for corporate debt restructuring, but its role was limited.

Bank closure and restructuring

31. The experiences of Indonesia and Korea suggest that a successful bank closure and restructuring program must include a comprehensive and well-communicated strategy in which transparent rules are consistently applied. The Korean program by and large achieved its objectives, largely because a comprehensive strategy was developed at the outset. The Indonesian banking sector program, by contrast, initially suffered from the lack of a comprehensive strategy and the failure to communicate the logic and outline of the policy to the public. As a result, the closure of 16 banks in November 1997, with subsequent reversals exacerbated, rather than dampened, the crisis. Bank closures in Indonesia in April 1998, however, were more successful because they were done as part of a comprehensive strategy that was well

communicated to the public and was based on the consistent application of uniform and transparent criteria.

32. The issue of whether a blanket guarantee, instead of the partial guarantee actually offered, should have been introduced in Indonesia in November deserves careful consideration. Our evaluation suggests that the banking crisis was not yet systemic in November, so that the partial guarantee was appropriate. In the end, the blanket guarantee introduced in January was subject to abuse and consequently raised the fiscal cost of bank restructuring. The problem in bank restructuring was more with the initial lack of a comprehensive and well-communicated strategy, and not the nature of the guarantee.

Structural conditionality

33. All three programs involved structural conditionality, but the experience with conditionality was very different. The Indonesian and Korean programs were characterized by extensive structural conditionality (especially the January 1998 Indonesian program) covering several areas that were not macro-critical. The scope of structural conditionality in the Brazilian program was limited to structural fiscal reform and prudential regulation. Part of this difference reflected the absence in Brazil of many of the distortions that had been present in Asia.
34. Measures to rehabilitate and reform the financial sector were necessary in both Indonesia and Korea and were appropriately included in the programs. In Indonesia, it was also important to tackle corporate restructuring by reforming the legal system, but this element was missing in the first two programs. As for the various nonfinancial structural reform measures included in the Indonesian and Korean programs, many of these may have been beneficial in improving long-run economic efficiency, but they were not necessary.
35. In Indonesia, many governance-related measures were included in the
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January program at the urging of some of the IMF's major shareholders in the belief that confidence could only be restored by signaling a clean break with the past. However, the evaluation suggests that the proliferation of nonfinancial structural conditionality led to a loss of focus on critical reforms in the banking sector which was more important for restoring stability. Proliferation of structural conditionality may also have led to lack of ownership at the highest political level and non-implementation, both of which damaged confidence.

Communications strategy

36. A program for restoring confidence must include a strategy to communicate the logic of the program to the public and the markets, in order to enhance country ownership and credibility. None of the three programs initially contained such a strategy.
37. Effective public communications are essential to build broad support for the program. Likewise, effective dialogue with the markets would improve program design through understanding the expectations of market participants, and also help build credibility for the program. For this purpose, it is important for the IMF to explain clearly the logic and strategy of the program, including spelling out the major risks, with a broad indication of how policies would respond to them.

D. Internal IMF Governance and the Mode of Operations

38. The evaluation identified a number of weaknesses in the IMF's internal governance and mode of operations. In the area of *human resource management practice*, the effectiveness of surveillance was reduced by the lack of sufficient internal incentives to make judgments that were frank and potentially unpopular (with country authorities), resulting in a tendency for sharper elements of a diagnosis to be diluted in final Executive Board papers. In crisis management, the quality of the IMF's
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response was compromised by a delay in the reallocation of staff resources to the Asia and Pacific Department (APD) whose staff was overstretched by multiple regional crises ; the insufficient integration of staff from MAE and the area department ; insufficient utilization of available internal knowledge ; and the failure to mobilize staff members with up-to-date country knowledge.

39. *The role of the Executive Board and the IMF's major shareholders* was particularly prominent during the crises, when major decisions needed to be made quickly, calling for close collaboration with staff and management. While the close involvement of the Board and the major shareholders was proper and necessary, close contacts at multiple layers unnecessarily subjected staff to micromanagement and political pressure, contributing to a blurring of technical and political judgments. For example, the visible presence of major country officials close to the IMF negotiating teams sometimes created a misperception of the motives behind IMF involvement, thus weakening the sense of country ownership.
40. In all three programs, the IMF collaborated, both in financing and technical work, with *other international financial institutions* (IFIs). When there was a clear separation of responsibilities, as in Brazil, no major problems occurred. In Asia, however, where the IMF and the other IFIs all worked in the financial sector, tensions developed over the role they should play in an IMF-supported program. While a good working relationship eventually developed, it depended too much on personalities, and not on a well-defined procedure. Moreover, existing procedures to resolve differences of view between the IMF and the World Bank on key policy matters were not effective in avoiding public criticism by the Chief Economist of the World Bank ; indeed, as far as the evaluation team can tell, these procedures were not utilized.
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〒103-0021 東京都中央区日本橋本石町1-3-2

Tel: 03-3245-6934 Fax: 03-3231-5422

e-mail: admin@iima.or.jp

URL: <http://www.iima.or.jp>

E. Recommendations

41. Since these crises, the IMF has taken numerous initiatives to strengthen surveillance and program design. Many of the weaknesses in surveillance and program design identified by the evaluation have already been addressed by the IMF in its revised policies and procedures. Nevertheless, additional steps will be necessary to further enhance the effectiveness of the IMF in surveillance and crisis management. We make six broad recommendations, which are set out in the final chapter of the report along with their rationale. Rather than summarize them again here, we suggest that Chapter VI be read in conjunction with this Executive Summary.