Contemporary Concerns Study, Term 4, PGP 2016-18

Does the IMF intervention really help the economies in crises?

A critical study of the IMF's lending conditionality

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Date – 27th August, 2017

Post Graduate Programme in Management, 2016-18

Indian Institute of Management Bangalore

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Introduction

In the past few decades, the International Monetary Fund (IMF) has been criticized for a variety of reasons. One of the criticisms is directed towards the conditionality imposed by the IMF on its member countries in economic distress. A simple analogy to this criticism is that the IMF has received backlash for being the doctor who prescribes the same *pill* irrespective of the *disease*. As the title of our study suggests, our primarily goal is to analyze the effectiveness, and more importantly the appropriateness, of the policies advised (imposed) by the IMF. We will also look at the other forms of criticism of the IMF and try to correlate or negate it with our findings. It's important to point out that this study is not aimed at proving the critics of the IMF right or wrong. Our goal is to look at the data available in the public forum, and to draw some conclusions regarding the relevance of an IMF program in the socio-economic setting of the borrowing country. To put things into perspective, it's important to know what the IMF does and what exactly is its lending program.

What is the IMF?

International Monetary Fund, an international organization with 189 member countries as of 2017, was established to promote trade between countries. Originally, it was envisioned to be the 'guarantor of fixed exchange rates among advanced countries.' But now, after the breakdown of the adjustable peg system in 1973, IMF primarily monitors the stability of the international monetary system, lends to its member countries in crises, and provides technical assistance and training.

Why is the IMF called the Financial Firefighter?

The IMF, typically called the lender of last resort, provides financial assistance to its member countries in need. For example, a country with balance of payment crisis without sufficient financing in the capital market, or a country with depleted international reserves and its currency under attack may turn to the IMF when the growth becomes stagnant resulting in unemployment and/or bankruptcy.

As per the IMF itself, about four out of five member countries have used the IMF credit at least once[1]. Here's a quick snapshot of the evolution of the IMF lending:

- Many lower- and lower-middle income countries borrowed from the IMF during the oil shock in 1970s and the sovereign-debt crisis (the lost decade) in 1980s.
- In the 1990s, several major financial crises took place in various parts of the world and many of these distressed economies turned towards IMF for help.
- The number of loans given out by the IMF dropped in 2004 and there was an increase in instances of countries repaying their IMF loans.
- The 2008 global financial crisis put the IMF back in spotlight as many more countries flocked to seek financial assistance from the IMF.

[1] IMF Lending, viewed on 27th August 2017, from http://www.imf.org/en/About/Factsheets/IMF-Lending

How does the IMF funding work?

The answer lies in the 'quota subscriptions' model of the IMF - which is central to its financial resources. Each member country, as per its relative position in the world economy, is assigned a quota. The quota further determines the maximum financial commitment of a member country to the IMF, its voting power, and its accessibility to the IMF loans.

Quotas are denominated in Special Drawing Rights (SDRs), the IMF's unit of account. The United States, having a current quota (as of March 2017) of SDR 82.99 billion (about US$113 billion), is the largest member of the IMF. And Tuvalu is the smallest member with a quota of SDR 2.5 million (about US$3.4 million). A member's quota subscription determines the maximum amount of financial resources the member is obliged to provide to the IMF, a member's voting power in the IMF decisions, and the amount of financing that a member can obtain from the IMF.

What is 'Conditionality'?

A typical IMF lending program has three components: the financial package (the money), structural reforms and macroeconomic policies. In a typical IMF lending program, these three elements are usually bundled together and can't be separated. In other words, the IMF loans often come attached with a set of policies[2] to be implemented by the borrowing country in crisis. These conditions are often developed by the IMF in negotiation with the country seeking the loans. The agreed loan amount is then disbursed in phases over the duration of the program. The payment at each phase depends of certain conditions/targets being met.

There are various types of lending programs (see Table 1 below) offered by the IMF and its usage usually depends on the nature of crisis/problem of the country. As mentioned earlier, the IMF attaches two different types of conditions to its loans:

- *Quantitative conditions*, known as Quantitative Performance Criteria (QPC) - macroeconomic targets that the government of the borrowing country is required to meet in order to avail loans from the IMF. These could include fiscal targets like the budget deficits, net assets, balance of payments, forex reserves etc.

- *Macroeconomic policies (Fiscal and Monetary) and Structural conditions* – i.e. IMF monitors the progress of the prescribed policies and the borrowing countries are required to implement the imposed conditions related to fiscal, monetary and structural reforms.

  There are two parts to this:
  Prior actions – are binding conditions that have to be fulfilled prior to the loan.
  Structural benchmarks – not binding, but the release of subsequent loans is tied to the government's performance in structural benchmarks.

[2] IMF Conditionality, viewed on 27th August 2017, from https://www.imf.org/en/About/Factsheets/Sheets/2016/08/02/21/28/IMF-Conditionality

Non-concessional lending - subject to the IMF's market-related interest rate	Stand-By Arrangement (SBA)	Used for short-term lending - 12-24 months long, repayment period within 3-5 years of disbursement. Maybe provided on a precautionary basis – i.e. the countries may earlier choose not to draw funds, however, it reserves the right to take loans if the conditions deteriorate.
	Flexible Credit Line (FCL)	For countries meeting certain pre-set qualification criteria. Single up-front disbursement rather than phased. Same terms as SBA.
	Precautionary and Liquidity (PLL)	For countries with "sound fundamentals and policies". Usually 6 months or 1-2 years long. Same terms as SBA. Limited conditionality.
	Extended Fund Facility (EFF)	For medium and long-term lending. Typically longer than SBAs—up to a maximum four years. Repayment due within 4½–10 years.
	Rapid Financing Instrument (RFI)	Emergency lending. Repayment within 3.5 – 5 years. Same terms as SBA.
Concessional Lending – only to low income countries; no interest charged	Extended Credit Facility (ECF)	Given to low income countries (LICs) with balance of payments problems. The loans carry zero interest rates and a maturity period of over 10 years, and a grace period of 5 years.
	Standby Credit Facility (SCF)	Used by LICs for short term lending. Can also be used on a precautionary basis. Carries zero interest rate, maturity of 8 years and grace period of 4 years.
	Rapid Credit Facility (RCF)	Emergency (immediate) lending to LICS. Carries no program-based conditionality with zero interest rates. Has a maturity period of 10 years and grace period of five and a half years.

Table 1: The IMF's current lending facilities/programs[3]

Literature Review

The IMF, despite being known as the financial crisis manager, doesn't have a good track record in getting many countries out of crisis. The packages offered by the IMF, along with the conditionality clause associated with it, have faced criticism. While assessing the impact of the IMF intervention, mixed findings have been reported in literature. Few found that the IMF did help (positive), while a few reported that the IMF intervention worsened the crisis (negative). And there are a few who argue that there is no relationship between the IMF packages and economic performance of the country seeking the loan (neutral) – i.e. it doesn't

[3] Lending Facilities, viewed on 27th August 2017, from https://www.imf.org/external/about/lending.htm#facilities

really matter whether the IMF intervenes or not. *Reichman and Stillson (1987)*[4], and *Conway (1994)*[5] supported the IMF stating that the lending programs provide significant benefits. *Bagci and Perraudin (1997)*[6], *Kahn (1990)*[7] reported positive impacts (both short- and long-term) of the IMF lending on the economy of the borrowing countries. *Morris & Shin (2006)*[8] suggested that the IMF lending works only when the borrowing countries apply the IMF conditioned policies.

In contrast, there are studies that talk about the negative effects of the IMF lending. *Bordo and Schwartz (2000)*[9] analysed the IMF lending during the 1972-1998 period and found that the performance of the borrowing countries deteriorated after they received the IMF support based on their analysis of the data from Latin American and Asian countries for the said period. Similarly, *Evrensel (2002)*[10] found that the economic conditions got worse for the countries that sought the IMF loans. *Dreher (2006)*[11] analysed data from 98 countries and reported that net impact of the IMF intervention is negative. *Barro and Lee (2005)*[12] analysed data from over 130 countries and found a negative correlation between economic growth of the borrowing countries and the IMF intervention. *Jorra (2012)*[13] was against the effectiveness of the IMF program and stated that the probability of the bailed-out country defaulting again increases after the IMF intervention.

A few studies reported that the IMF bailout interventions had no significant impact on the status quo. For example, *Donovan (1982)*[14] analysed the IMF programs during 1970-1980, and argued that though the balance of payments of the borrowing countries did increase, there was no significant economic growth. *Atoyan and Conway (2005)*[15] studied the IMF lending in 95 developing countries for the period 1993–2002, and identified the IMF doesn't improve the economic in the short-term, but in the long-term, evidence of economic growth can be found. Similarly, *Zwart (2007)*[16] states that the IMF programs can have positive as well as

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[4] T.M. Reichman, T. Stillson, 'Experience with programs of balance of payments adjustment in the higher tranches', 1963–72, IMF Staff Papers, 25 (1987), pp. 293-309

[5] P. Conway, 'IMF lending programs: Participation and impact', Journal of Development Economics, 45 (1994), pp. 365-391, viewed on 27th Aug 2017, from http://bit.ly/2uCUIkt

[6] P. Bagci, W. Perraudin, 'Do IMF programs work?', Global economic institutions working paper (1997)

[7] M.S. Kahn, 'The macroeconomic effects of Fund-supported adjustment programs', IMF Staff Papers, 37 (1990), pp. 195-231, viewed on 27th August 2017, from http://bit.ly/2u2T7B0

[8] S. Morris, H.S. Shin, 'Catalytic finance: When does it work?', Journal of International Economics, 70 (2006), pp. 161-177

[9] M. Bordo, A.J. Schwartz, 'Measuring real economic effects of bailouts: Historical perspectives on how countries in financial distress have fared with and without bailouts (2000)', viewed on 27th August 2017, from http://www.nber.org/papers/w7701

[10] A. Evrensel, 'Effectiveness of IMF-supported stabilization programs in developing countries', Journal of International Money and Finance, 21 (5) (2002), pp. 565-587, viewed on 27th August 2017, from http://bit.ly/2w4u01Z

[11] A. Dreher, 'IMF and economic growth: The effects of programs, loans, and compliance with conditionality', World Development, 34 (2006), pp. 769-788, viewed on 27th August 2017, from http://bit.ly/2uH6E3d

[12] R.J. Barro, J.W. Lee, 'IMF programs: Who is chosen and what are the effects?', Journal of Monetary Economics, 52 (2005), pp. 1245-1269, viewed on 27th August 2017, from http://bit.ly/2vOi59A

[13] M. Jorra, 'The effect of IMF lending on the probability of sovereign debt crises', Journal of International Money and Finance, 31 (2012), pp. 709-725, viewed on 27th August 2017, from http://bit.ly/2uHdx4F

[14] D.J. Donovan, 'Macroeconomic performance under fund-supported programs: The experience of the seventies', IMF Staff Papers, 29 (1982), pp. 171-203

[15] R. Atoyan, P. Conway, 'Evaluating the impact of IMF programs: A comparison of matching and instrumental-variable estimators',
Review of International Organizations, 1 (2) (2005), pp. 99-124

[16] S. Zwart, 'The mixed blessing of IMF intervention: Signalling versus liquidity support', Journal of Financial Stability, 3 (2007), pp. 149-174, viewed on 27th August 2017, from http://bit.ly/2u2VAvg

negative impact, though the loans do provide a way to address the short-term needs, the long-term effects of the loans depend on the conditionality imposed, and often, the timing of the loans also has a role to play.

Purpose of this study

Given the inconsistent nature of previous findings in assessing the IMF's bail-out package, the purpose of this study is to critically examine a few important and under-researched elements of the IMF lending packages. More specifically, we aim to analyse whether the IMF packages are designed and implemented while taking the political and social condition of the borrowing country into consideration.

Methodology

We have analysed the IMF lending to different countries through the social, political and economic lenses. Our approach includes comparing the economic performance before and after the IMF intervention, comparison of the conditionality imposed by the IMF on the borrowing countries, and comparing the *success* and *failure* cases. Our study also focuses on assessing the socio-political conditions of the borrowing countries before and after the IMF intervened. Though we have particularly looked into IMF lending to eight countries during the 1992-2002 period, our analysis also picks up relevant examples from other IMF lending programs. The data for the study has been collected from the public forums – World Bank, the IMF website, Independent Evaluation Office of the IMF, World Trade Organisation reports, previous literature, and research papers by eminent economists.

Critical Study of the IMF Lending Conditionality

We carried out a timeline analysis of the IMF lending over a period of 1990-2002. Though there have been numerous instances of the IMF lending during this period, we specifically looked at the data for eight different economies in crisis who sought help from the IMF. These are some of major financial crisis to have taken place during the 1990s:

- 1994 Mexican Peso/Tequila Crisis
- 1997 Asian Financial Crisis (particularly Thailand, Korea, Indonesia)
- 1998 Brazil Currency Crisis
- 1998 Russian *Ruble* Crisis
- 1998-2002 Argentina Great Depression and
- 2001 Turkey's Economic Crisis

As mentioned earlier, the foundation of IMF criticism is based on the argument that the IMF is known to use a *blanket approach* while imposing conditional policies on the borrowing countries. To support or negate this, the first half of the study involves looking into the eight aforementioned countries – the background of the crisis, the political and economic setting of the borrowing country in crisis, approach of the IMF in giving out loans - the IMF imposed policies, the macroeconomic health of the borrowing country before and after IMF intervention. The IMF policies are then critically analyzed through different social, economic and political points of view.

Out of these eight countries, three (Mexico, Indonesia and Argentina) have been discussed in a relatively greater detail in the second half of this study.

A brief look at the eight countries in crisis during 1990-2002

Table 2 below is aimed at giving a background of the crisis – highlighting the political and social backdrop of the borrowing countries.

	Brief background of the crisis	**Other remarks – *political and social* stability**
Mexico (1994)	Mexico enjoyed investor confidence due to the NAFTA agreement. Political instability lead to the loss of investor confidence. *Peso* pegged to US dollar, demand for imports increased due to *peso*'s strength resulting in trade deficit, Capital began flowing out increasing the downward pressure on the *peso*.	Unstable : violence in Chiapas, assassination of President, Election pressure to maintain money supply, USA's evident political interests in Mexico because of NAFTA.
Thailand (1997)	Thai *baht*, pegged to the US dollar, was hit by massive speculative attacks.	PM initially not ready to devalue *Baht*. Social unrest due to massive layoffs in finance, real estate and finance
Indonesia (1997)	When Thailand floated the *baht*, Indonesia widened the *rupiah* currency trading band from 8% to 12%. The *rupiah* then came under severe attack leading to massive capital flight from the economy.	Major political upheaval during the crisis, President Suharto resigned after three decades due to social unrest – riots, violence, shootings, corruption
South Korea (1997)	Large conglomerates (chaebol) relied on external debt financing. Businesses failed to make profits. Excess debt led to their collapse. South Korean *won* depreciated.	-
Brazil (1998)	In 1990s, Brazil fought inflation with high interest rates and crawling peg of real. Investors poured in money due to high interest rates, FDI grew over 140% over the year before, country began to run current account deficits. Brazil then depleted its reserves to finance this deficit. Spill over effects from Asian and Russian crisis - loss of investor confidence.	-
Russia (1998)	Decreasing productivity, a high fixed exchange rate, and a high fiscal deficit led to the crisis. War of Chechnya was another factor, along with the loss in demand for oil and non-ferrous metals lessened forex reserves. Investors fled the market by selling Russian *ruble* and assets.	President dismissed PM and entire cabinet of ministers, Social unrest - workers went on strike, blocked railways.
Argentina (1999)	Argentina Currency Board pegged the Argentinean *peso* pegged to dollar (the convertibility plan), and Brazil devalued its real in 1999. Investors moved to Brazil from Argentina. Export and foreign investment dried up. Extensive foreign and domestic debt of government, Privatization lead to increase in price for basic services - companies lost demand and business	Social unrest due to recessionary pressures and *peso* losing its value, withdrawal limits placed on banks, Buenos Aires riots took place in 2001
Turkey (2001)	In 1990s, Turkey experienced low growth rates, high inflation and capital account liberalization. Interest on government debt increased, creating arbitrage for private banks.	Political fight between two major party leaders. People and investors lost confidence.

Table 2: Background of the borrowing countries in crisis

History of IMF Lending to the economies in crisis

Table 3 looks at the history of the IMF lending with the countries of our study. It also gives details about the amount of loans that were part of the agreements.

Mexico – as of 31 Jan, 2015 FCL - Nov 26, 2014 : 4,72,92,000 FCL - Mar 25, 2010: 3,15,28,000 SBA- Jul 07, 1999 : 31,03,000 SBA - Feb 01, 1995: 1,20,70,200 EFF - May 26, 1989 : 37,29,600 SBA - Nov 19, 1986 : 14,00,000 EFF - Jan 01, 1983 : 34,10,625 EFF - Jan 01, 1977 : 5,18,000 SBA - Jul 13, 1961 : 90,000 SBA - Mar 05, 1959 : 90,000 SBA - Apr 16, 1954 : 50,000 **Russia – as of 31 Jan, 2014** SBA - Jul 28, 1999 : 33,00,000 EFF - Mar 26, 1996 : 1,32,06,570 SBA - Apr 11, 1995 : 43,13,100 SBA - Aug 05, 1992 : 7,19,000	**Thailand – as of 31 Dec, 2001** SBA- Aug 20, 1997 : 29,00,000 SBA - Jun 14, 1985 : 4,00,000 SBA - Nov 17, 1982 : 2,71,500 SBA - Jun 03, 1981 : 8,14,500 SBA - Jul 01, 1978 : 45,250 **Indonesia – as of 30 Nov, 2014** EFF - Feb 04, 2000 : 36,38,000 EFF - Aug 25, 1998 : 53,83,100 SBA - Nov 05, 1997 : 83,38,240 SBA - May 04, 1973 : 50,000 SBA - Apr 17, 1972 : 50,000 SBA - Apr 22, 1971 : 50,000 SBA - Apr 17, 1970 : 46,300 SBA - Apr 04, 1969 : 70,000 SBA - Feb 19, 1968 : 51,750 SBA - Aug 01, 1963 : 50,000 SBA - Aug 16, 1961 : 41,250	**South Korea – as of 31 Dec, 2015** SBA - Dec 04, 1997 : 1,55,00,000 SBA - JUL 12, 1985 : 2,80,000 SBA - Jul 08, 1983 : 5,75,775 SBA - Feb 13, 1981 : 5,76,000 SBA - Mar 03, 1980 : 6,40,000 SBA - May 06, 1977 : 20,000 SBA - Oct 22, 1975 : 20,000 SBA - May 17, 1974 : 20,000 SBA - Apr 02, 1973 : 20,000 SBA - Jan 01, 1972 : 30,000 SBA - Jan 01, 1971 : 25,000 SBA - Mar 13, 1970 : 25,000 SBA - Apr 15, 1969 : 25,000 SBA - APR 11, 1968 : 25,000 SBA - Mar 22, 1967 : 18,000 SBA- Mar 22, 1966 : 12,000 SBA- Mar 22, 1965 : 9,300
Argentina – as of 31 May, 2005 SBA - Sep 20, 2003 : 89,81,000 SBA - Jan 24, 2003 : 21,74,500 SBA - Mar 10, 2000 : 1,69,36,800 EFF - Feb 04, 1998 : 20,80,000 SBA - Apr 12, 1996 : 7,20,000 EFF - Mar 31, 1992 : 40,20,250 SBA - Jul 29, 1991 : 7,80,000 SBA - Nov 10, 1989 : 7,36,000 SBA - Jul 23, 1987 : 9,47,500 SBA - Dec 28, 1984 : 11,82,500 SBA - Jan 24, 1983 : 15,00,000 SBA - Sep 16, 1977 : 1,59,500 SBA - Aug 06, 1976 : 2,60,000 SBA - Apr 15, 1968 : 1,25,000 SBA - May 01, 1967 : 1,25,000 SBA - Jun 07, 1962 : 1,00,000 SBA - Dec 12, 1961 : 1,00,000 SBA - Dec 12, 1960 : 1,00,000 SBA - Dec 03, 1959 : 1,00,000 SBA - Dec 19, 1958 : 75,000	**Brazil – as of 31 Aug, 2013** SBA - Sep 06, 2002 : 2,73,75,120 SBA - Sep 14, 2001 : 1,21,44,400 SBA - Dec 02, 1998 : 1,30,24,800 SBA - Jan 29, 1992 : 15,00,000 SBA - Aug 23, 1988 : 10,96,000 EFF - Feb 28, 1983 : 42,39,375 SBA - Mar 03, 1972 : 50,000 SBA - Feb 04, 1971 : 50,000 SBA - Feb 04, 1970 : 50,000 SBA - Apr 29, 1969 : 50,000 SBA - Apr 29, 1968 : 87,500 SBA - Feb 13, 1967 : 30,000 SBA - Feb 01, 1966 : 1,25,000 SBA - Jan 13, 1965 : 1,25,000 SBA - May 18, 1961 : 1,60,000 SBA - Jun 03, 1958 : 37,500	**Turkey – as of 31 March, 2008** SBA - May 11, 2005 : 66,62,040 SBA - Feb 04, 2002 : 1,28,21,200 SBA - Dec 22, 1999 : 1,50,38,400 SBA - Jul 08, 1994 : 6,10,500 SBA - Apr 04, 1984 : 2,25,000 SBA - Jun 24, 1983 : 2,25,000 SBA - Jun 18, 198 : 12,50,000 SBA - Jul 19, 1979 : 2,50,000 SBA - Apr 24, 1978 : 3,00,000 SBA - Aug 17, 1970 : 90,000 SBA - Jul 01, 1969 : 27,000 SBA - Apr 01, 1968 : 27,000 SBA - Feb 15, 1967 : 27,000 SBA - Feb 01, 1966 : 21,500 SBA - Feb 01, 1965 : 21,500

Table 3: Past lending agreements between the countries and the IMF[17]

- Format of the data given in the Table 2 is:
  Facility Name (for example, SBA) – Arrangement Date : Amount Agreed (in SDR)
- The ones highlighted denote the loans taken by the countries during the said crisis.
- Currently, 1 USD = 0.708581 SDR[18]

[17] History of IMF lending arrangements, viewed on 27th August 2017, from http://www.imf.org/en/Data
[18] SDR valuation, viewed on 27th August 2017, from https://www.imf.org/external/np/fin/data/rms_sdrv.aspx

Comparison of the IMF Conditionality

In Table 4, we have mapped the various policy conditions imposed by the IMF on these countries. Since there can be as many as 80 or more policy agreements advised by the IMF, it'd be difficult to analyze each one of them separately. The policies have been divided into three broad categories. For example, we have analyzed whether these countries were asked to tighten their fiscal policy through expenditure cuts, or whether they were given the liberty to spend. Similarly, under monetary policy, we have grouped various policies that encourage or discourage policies related to open market operations or flexible/fixed exchange rate.

	Mexico (1994)	Thailand (1997)	Indonesia (1997)	South Korea (1997)	Brazil (1998)	Russia (1998)	Argentina (1999)	Turkey (2001)
Fiscal Policy								
Fiscal Tightening - Decreased government spending/expenditure cuts	✓	✓	✓	✓	✓	✓	✓	✓
Fiscal Targets given	✓	✓	✓	✓	✓	✓	✓	✓
Tax Reforms - increase in tax revenues	✓	✓	✓	✓	✓	✓	✓	✓
Wage Reforms - reduction in wages/limited increase	✓	✓	✓	✗	✗	✗	✗	✗
Decrease in public sector employment	✗	✗	✗	✗	✗	✓	✗	✓
Monetary Policy								
Tightening Monetary Policy – increase in interest rates/ discount rates/reserve requirements	✓	✓	✓	✓	✓	✓	✓	✓
Push for flexible exchange rate	✓	✓	✓	✓	✓	✓	✓	✓
Push for open market operations	✓	✓	✓	✓	✓	✓	✗	✓
Structural Reforms								
Push for privatization of various sectors	✓	✓	✓	✗	✓	✓	✓	✓
Financial Sector/Bank Restructuring	✗	✓	✓	✓	✓	✓	✓	✓
Administrative and Legal Reforms - Introduction of new laws	✓	✓	✓	✓	✓	✓	✓	✓
Trade Liberalization	✗	✗	✓	✓	✓	✓	✓	✓
Labour Market Reforms	✗	✗	✓	✓	✓	✗	✗	✓
Other exclusive sectoral reforms like Agriculture, Healthcare	✓	✗	✗	✗	✗	✗	✓	✓

Table 4 - Fiscal and Monetary Policies, Structural Reforms recommended by the IMF[19]

[19] Letters of Intent, viewed on 27th August 2017, from https://www.imf.org/external/country/idn/index.htm?type=23

Macroeconomic health of the countries in crisis

Table 5.1*: Charts showing three key macroeconomic indicators of the economies in crisis

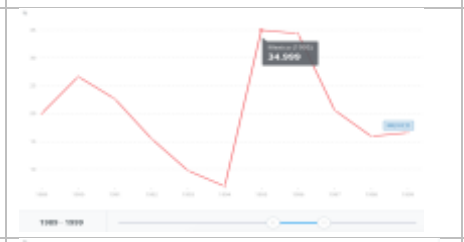
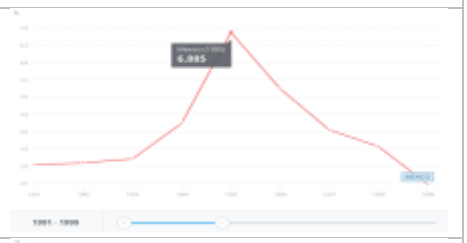
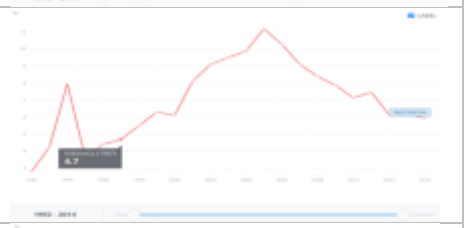
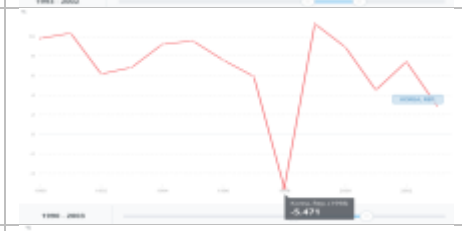
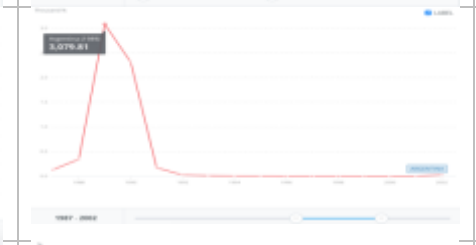
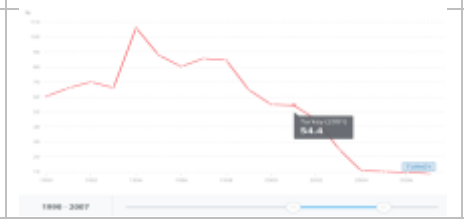
	Annual Real GDP Growth (%)	Inflation (in terms of CPI, %)	Unemployment (as a % of total workforce)
Mexico (1994)			
Thailand (1997)			
Indonesia (1997)			
S Korea (1997)			
Brazil (1998)			
Russia (1998)			
Argentina (1999)			
Turkey (2001)			

Table 5.2* – GDP growth (annual %) combined chart

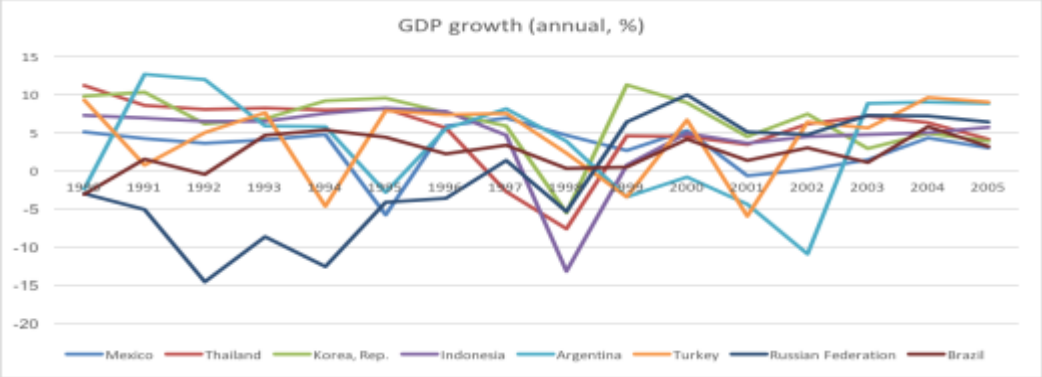


Table 5.3* – Unemployment (% of total labor force) combined chart

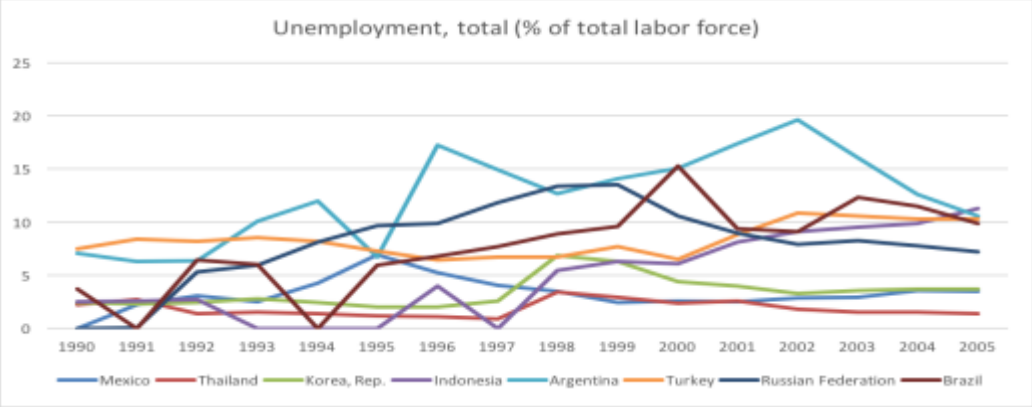


Table 5.4* – Inflation (CPI, annual %) combined chart

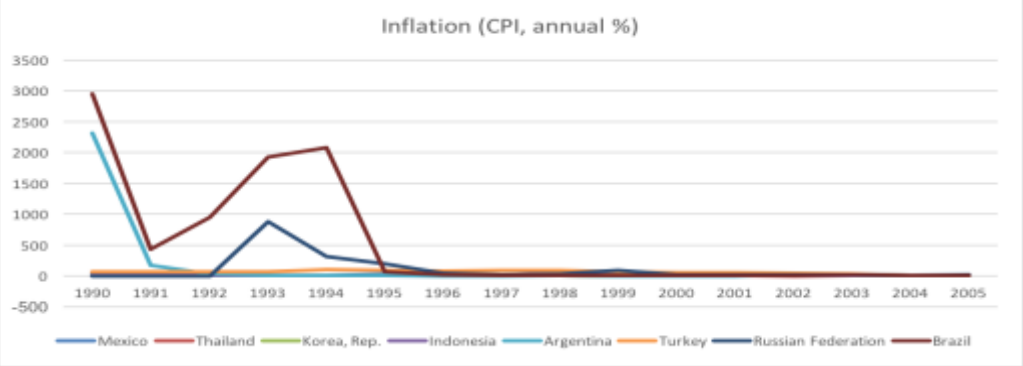
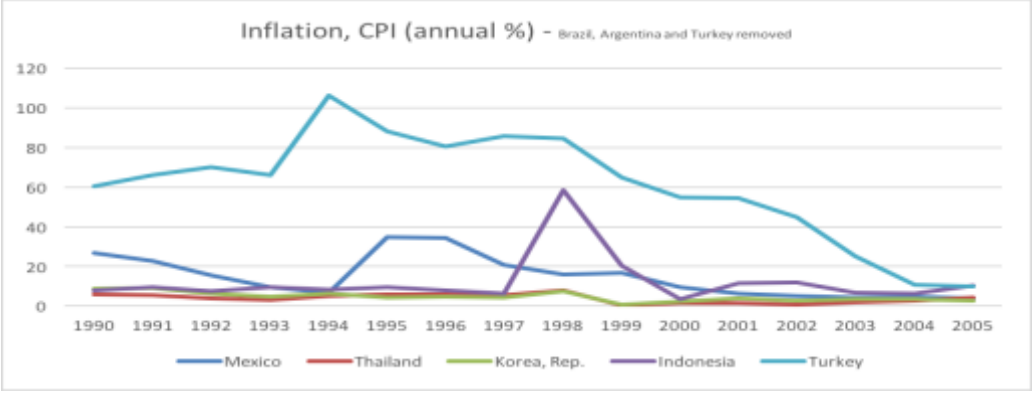


Table 5.5* – Inflation (CPI, annual %) combined chart – except Brazil, Argentina and Turkey[20]



[20] *World Bank country wise data, viewed on 27th August 2017, from http://databank.worldbank.org/data

Table 6.1** – Other macroeconomic indicators of Mexico (1991-98)[21]

Mexico (1994)

Macroeconomic Indicator	1991	1992	1993	1994	1995	1996	1997	1998
GDP growth (annual %)	4.22	3.63	4.06	4.73	-5.76	5.87	6.96	4.70
Official exchange rate (LCU per US$, period average)	3.02	3.09	3.12	3.38	6.42	7.60	7.92	9.14
Broad money growth (annual %)	49.21	23.57	16.90	20.11	31.86	27.01	56.85	17.45
Inflation, consumer prices (annual %)	22.66	15.51	9.75	6.97	35.00	34.38	20.63	15.93
Unemployment, total (% of total labor force)	2.21	3.10	2.47	4.25	6.93	5.24	4.03	3.52
Exports of goods and services (% of GDP)	16.36	15.24	12.14	13.34	25.17	26.73	25.23	25.75
Imports of goods and services (% of GDP)	19.27	20.27	13.82	15.96	20.94	24.00	24.09	26.03
Gross savings (% of GDP)	18.56	16.55	15.64	15.20	18.45	19.33	19.15	19.93
Trade (% of GDP)	35.64	35.51	25.97	29.30	46.11	50.72	49.32	51.78
Lending interest rate (%)	..	..	17.73	19.30	59.43	36.39	22.14	26.36
Real interest rate (%)	..	..	-12.20	10.23	21.17	5.52	3.69	9.77
Deposit interest rate (%)	17.97	15.88	16.69	15.03	39.82	26.40	16.36	15.45
Foreign direct investment, net inflows (% of GDP)	1.51	1.21	0.87	2.08	2.77	2.31	2.67	2.54
Foreign direct investment, net outflows (% of GDP)	0.06	0.18	-0.02	0.20	-0.08	0.01	0.23	0.27
Current account balance (BoP, in current US$)	-14888000000	-24442000000	-23400000000	-29662110000	-1576440000	-2507747000	-7664937000	-15992658000

Table 6.2** – Other macroeconomic indicators of Indonesia (1994-01)

Indonesia (1997)

Macroeconomic Indicator	1994	1995	1996	1997	1998	1999	2000	2001
GDP growth (annual %)	7.54	8.22	7.82	4.70	-13.13	0.79	4.92	3.64
Official exchange rate (LCU per US$, period average)	2160.75	2248.61	2342.30	2909.38	10013.62	7855.15	8421.78	10260.85
Broad money growth (annual %)	20.20	27.52	27.08	25.25	62.76	12.23	16.62	11.87
Inflation, consumer prices (annual %)	8.52	9.43	7.97	6.23	58.39	20.49	3.72	11.50
Unemployment, total (% of total labor force)	..	..	4.00	..	5.46	6.30	6.08	8.10
Exports of goods and services (% of GDP)	26.51	26.31	25.82	27.86	52.97	35.51	40.98	39.03
Imports of goods and services (% of GDP)	25.37	27.65	26.44	28.13	43.22	27.43	30.46	30.76
Gross savings (% of GDP)	29.87	28.14	27.81	29.03	22.42	13.20	27.23	28.05
Trade (% of GDP)	51.88	53.96	52.26	55.99	96.19	62.94	71.44	69.79
Lending interest rate (%)	17.76	18.85	19.22	21.82	32.15	27.66	18.46	18.55
Real interest rate (%)	9.26	8.16	9.70	8.21	-24.60	11.83	-1.65	3.72
Deposit interest rate (%)	12.53	16.72	17.26	20.01	39.07	25.74	12.50	15.48
Foreign direct investment, net inflows (% of GDP)	1.19	2.15	2.72	2.17	-0.25	-1.33	-2.76	-1.86
Foreign direct investment, net outflows (% of GDP)	0.34	0.30	0.26	0.08	..	..	..	..
Current account balance (BoP, current US$)	-2792000000	-6431000000	-7663000000	-4889000000	4096965770	5782898398	7992074101	6900901091

Table 6.3** – Other macroeconomic indicators of Thailand (1994-01)

Thailand (1997)

Macroeconomic Indicator	1994	1995	1996	1997	1998	1999	2000	2001
GDP growth (annual %)	8.00	8.12	5.65	-2.75	-7.63	4.57	4.46	3.44
Official exchange rate (LCU per US$, period average)	25.15	24.92	25.34	31.36	41.36	37.81	40.11	44.43
Broad money growth (annual %)	10.69	17.74	10.62	19.55	10.07	3.80	4.91	5.46
Inflation, consumer prices (annual %)	5.05	5.82	5.81	5.63	7.99	0.28	1.59	1.63
Unemployment, total (% of total labor force)	1.35	1.14	1.07	0.87	3.40	2.96	2.39	2.60
Exports of goods and services (% of GDP)	38.24	41.53	39.02	48.24	57.94	56.44	64.84	63.25
Imports of goods and services (% of GDP)	43.01	48.22	45.26	46.81	42.30	44.27	56.46	57.02
Gross savings (% of GDP)	35.13	34.53	34.19	33.04	32.19	29.56	29.16	27.05
Trade (% of GDP)	81.25	89.76	84.27	95.05	100.24	100.71	121.30	120.27
Lending interest rate (%)	10.90	13.25	13.40	13.65	14.42	8.98	7.83	7.25
Real interest rate (%)	5.95	7.10	8.93	8.83	5.88	11.86	6.42	5.23
Deposit interest rate (%)	8.46	11.58	10.33	10.52	10.65	4.77	3.29	2.54
Foreign direct investment, net inflows (% of GDP)	0.93	1.22	1.28	2.59	6.43	4.82	2.66	4.21
Foreign direct investment, net outflows (% of GDP)	0.34	0.52	0.51	0.39	0.11	0.27	-0.02	0.36
Current account balance (BoP, current US$)	-8058935440	-13581744650	-14691474457	-3021103817	14242468917	12427871817	9313150885	5100898194

Table 6.4** – Other macroeconomic indicators of Korea (1994-01)

Korea (1997)

Macroeconomic Indicator	1994	1995	1996	1997	1998	1999	2000	2001
GDP growth (annual %)	9.21	9.57	7.59	5.92	-5.47	11.31	8.92	4.53
Official exchange rate (LCU per US$, period average)	803.45	771.27	804.45	951.29	1401.44	1188.82	1130.96	1290.99
Broad money growth (annual %)	18.68	15.59	15.83	14.14	27.03	27.38	25.43	85.20
Inflation, consumer prices (annual %)	6.26	4.48	4.92	4.45	7.51	0.81	2.27	4.07
Unemployment, total (% of total labor force)	2.41	2.01	2.02	2.59	6.82	6.26	4.42	4.00
Exports of goods and services (% of GDP)	24.25	25.93	25.28	28.98	40.39	33.56	35.01	32.73
Imports of goods and services (% of GDP)	24.63	26.85	28.22	29.66	29.60	27.87	32.94	31.18
Gross savings (% of GDP)	38.00	37.69	36.28	36.19	37.93	35.62	34.25	32.19
Trade (% of GDP)	48.88	52.79	53.50	58.63	69.99	61.44	67.95	63.91
Lending interest rate (%)	8.50	9.00	8.84	11.88	15.28	9.40	8.55	7.71
Real interest rate (%)	0.37	1.93	4.40	7.51	10.19	10.71	7.38	3.91
Deposit interest rate (%)	8.50	8.83	7.50	10.81	13.29	7.95	7.94	5.79
Foreign direct investment, net inflows (% of GDP)	0.18	0.32	0.39	0.51	1.45	1.92	2.05	1.22
Foreign direct investment, net outflows (% of GDP)	0.57	0.70	0.83	0.79	1.13	0.82	0.86	0.51
Current account balance (BoP, current US$)	-4463700000	-9751500000	-23830900000	-10285300000	40056900000	21608200000	10444300000	2700200000

[21] **World Bank country wise data, viewed on 27th August 2017, from http://databank.worldbank.org/data

Table 6.5** – Other macroeconomic indicators of Russia (1995-02)

Russia (1998)

Macroeconomic Indicator	1995	1996	1997	1998	1999	2000	2001	2002
GDP growth (annual %)	-4.14	-3.60	1.40	-5.30	6.40	10.00	5.09	4.74
Official exchange rate (LCU per US$, period average)	4.56	5.12	5.78	9.71	24.62	28.13	29.17	31.35
Broad money growth (annual %)	112.58	29.56	28.85	37.64	56.75	57.93	36.31	33.76
Inflation, consumer prices (annual %)	197.47	47.74	14.77	27.67	85.74	20.78	21.46	15.79
Unemployment, total (% of total labor force)	9.66	9.86	11.81	13.39	13.53	10.58	8.98	7.92
Exports of goods and services (% of GDP)	29.29	26.07	24.73	31.22	43.22	44.06	36.89	35.25
Imports of goods and services (% of GDP)	25.89	21.85	22.53	24.55	26.17	24.03	24.22	24.46
Gross savings (% of GDP)	28.02	26.52	21.95	17.16	28.25	36.15	32.96	28.72
Trade (% of GDP)	55.18	47.92	47.26	55.77	69.39	68.09	61.11	59.71
Lending interest rate (%)	320.31	146.81	32.04	41.79	39.72	24.43	17.91	15.70
Real interest rate (%)	72.26	69.28	14.76	19.62	-18.95	-9.63	1.22	0.18
Deposit interest rate (%)	101.96	55.05	16.77	17.05	13.68	6.51	4.85	4.95
Foreign direct investment, net inflows (% of GDP)	0.52	0.66	1.20	1.02	1.69	1.03	0.93	1.01
Foreign direct investment, net outflows (% of GDP)	0.15	0.24	0.79	0.47	1.13	1.22	0.83	1.02
Current account balance (BoP, current US$)	6962675326	10846819533	-835240000	71060000	22855420000	45382380000	32053820000	27472950000

Table 6.6** – Other macroeconomic indicators of Brazil (1995-02)

Brazil (1998)

Macroeconomic Indicator	1995	1996	1997	1998	1999	2000	2001	2002
GDP growth (annual %)	4.42	2.21	3.40	0.34	0.47	4.11	1.39	3.05
Official exchange rate (LCU per US$, period average)	0.92	1.01	1.08	1.16	1.81	1.83	2.35	2.92
Broad money growth (annual %)	44.30	31.03	17.24	12.02	18.12	19.70	37.88	6.63
Inflation, consumer prices (annual %)	66.01	15.76	6.93	3.20	4.86	7.04	6.84	8.45
Unemployment, total (% of total labor force)	5.95	6.77	7.68	8.90	9.61	15.28	9.35	9.11
Exports of goods and services (% of GDP)	7.37	6.73	6.98	7.03	9.56	10.19	12.37	14.23
Imports of goods and services (% of GDP)	9.26	8.91	9.59	9.41	11.42	12.45	14.56	13.39
Gross savings (% of GDP)	14.21	12.69	12.17	11.53	10.60	12.52	12.35	14.54
Trade (% of GDP)	16.63	15.64	16.58	16.44	20.98	22.64	26.94	27.62
Lending interest rate (%)	..	..	78.19	86.36	80.44	56.83	57.62	62.88
Real interest rate (%)	..	..	65.41	77.62	67.06	48.11	45.64	48.34
Deposit interest rate (%)	52.25	26.45	24.35	28.00	26.02	17.20	17.86	19.14
Foreign direct investment, net inflows (% of GDP)	0.62	1.32	2.22	3.69	4.77	5.03	4.15	3.27
Foreign direct investment, net outflows (% of GDP)	0.18	0.10	0.12	0.32	0.25	0.38	-0.27	0.49
Current account balance (BoP, current US$)	-18136000000	-23248000000	-30491000000	-33829000000	-25400000000	-24224529661	-23214529000	-7636629351

Table 6.7** – Other macroeconomic indicators of Argentina (1996-03)

Argentina (1999)

Macroeconomic Indicator	1996	1997	1998	1999	2000	2001	2002	2003
GDP growth (annual %)	5.53	8.11	3.85	-3.39	-0.79	-4.41	-10.89	8.84
Official exchange rate (LCU per US$, period average)	1.00	1.00	1.00	1.00	1.00	1.00	3.06	2.90
Broad money growth (annual %)	18.82	25.53	10.49	4.09	1.53	-19.44	19.71	29.63
Inflation, consumer prices (annual %)	0.16	0.53	0.92	-1.17	-0.94	-1.07	25.87	13.44
Unemployment, total (% of total labor force)	17.20	14.89	12.69	14.10	15.02	17.35	19.61	16.03
Exports of goods and services (% of GDP)	10.43	10.56	10.42	9.83	10.99	11.58	28.38	25.93
Imports of goods and services (% of GDP)	11.08	12.78	12.93	11.56	11.64	10.27	13.37	14.71
Gross savings (% of GDP)	15.59	15.21	15.09	13.81	13.03	12.77	20.31	20.61
Trade (% of GDP)	21.51	23.34	23.35	21.38	22.62	21.85	41.75	40.64
Lending interest rate (%)	10.51	9.24	10.64	11.04	11.09	27.71	51.68	19.15
Real interest rate (%)	10.57	9.75	12.55	13.12	9.95	29.12	16.18	7.83
Deposit interest rate (%)	7.36	6.97	7.56	8.05	8.34	16.16	39.25	10.16
Foreign direct investment, net inflows (% of GDP)	2.55	3.13	2.44	8.46	3.67	0.81	2.20	1.29
Foreign direct investment, net outflows (% of GDP)	0.59	1.25	0.78	0.61	0.32	0.06	-0.64	0.61
Current account balance (BoP, current US$)	-6769978160	-12138068595	-14481998042	-11942825328	-8980617893	-3780423241	8766610000	8139930000

Table 6.8** – Other macroeconomic indicators of Turkey (2001-05)

Turkey (2001)

Macroeconomic Indicator	1998	1999	2000	2001	2002	2003	2004	2005
GDP growth (annual %)	2.31	-3.39	6.64	-5.96	6.43	5.61	9.64	9.01
Official exchange rate (LCU per US$, period average)	0.26	0.42	0.63	1.23	1.51	1.50	1.43	1.34
Broad money growth (annual %)	89.32	101.99	40.66	87.41	29.90	14.44	20.79	35.97
Inflation, consumer prices (annual %)	84.64	64.87	54.92	54.40	44.96	25.30	10.58	10.14
Unemployment, total (% of total labor force)	6.70	7.66	6.51	8.84	10.86	10.55	10.28	10.26
Exports of goods and services (% of GDP)	20.57	18.58	19.45	26.58	24.46	22.24	22.75	21.02
Imports of goods and services (% of GDP)	19.71	18.82	22.55	22.82	23.00	23.36	25.37	24.42
Gross savings (% of GDP)	25.63	21.62	20.98	20.89	21.81	19.90	21.48	22.85
Trade (% of GDP)	40.27	37.40	42.00	49.40	47.46	45.60	48.12	45.44
Deposit interest rate (%)	80.11	78.43	47.16	74.70	50.49	37.68	24.26	20.40
Foreign direct investment, net inflows (% of GDP)	0.34	0.31	0.36	1.67	0.45	0.55	0.69	2.00
Foreign direct investment, net outflows (% of GDP)	0.13	0.25	0.32	0.25	0.06	0.15	0.19	0.21
Current account balance (BoP, current US$)	2000000000	-925000000	-9920000000	3760000000	-626000000	-7554000000	-14198000000	-20980000000

Tables 5 and 6 look at the major macroeconomic indicators for these countries – like Annual Real GDP growth (%), Inflation, Unemployment, Broad Money Growth, FDI, Interest Rates etc. This will help us understand how these parameters changed prior, during and after crisis, and how the economy of the countries fared in the short- and the long-term after the IMF intervened.

There is no one underlying factor that gives rise to a crisis, and a lot of forces are at play here. But it's interesting to note that almost all the eight countries in our study were running a current account deficit which led up to a balance of payment crisis. These countries also followed a fixed exchange rate system wherein their local currency was pegged to the US dollar. Though the aim for a fixed exchange rate is to increase the trade competitiveness of the country, there is also a need to maintain sufficient international reserves to support the peg. The international reserves can be increased when the country earns or receives foreign money – which essentially means an increase in FDIs, exports or dollar denominated government bonds (loans). Increase in the inflow of FDIs, as listed in the Table 6, suggests that investors have confidence in the economy. As an investor, I'd invest in something that generates returns, and would start pulling out my money if I feel that there's going to be a crisis soon, and this leads to speculative attack when everybody starts pulling out money from the country. Often to restore this confidence, the borrowing country increases the interest rate. When a country borrows foreign money, and doesn't generate enough returns to payback the loans (could be due to sluggish GDP growth), it runs into a crisis – which results in a dramatic increase in unemployment and inflation.

Analysis

To set the context for the discussion on the IMF's approach to giving policy recommendations, we will first try to analyze the underlying social, economic and political factor that led to the crisis for the countries in our study.

Economic, social and political overview of the countries in crisis

1994, Mexico[22] *(Table 6.1)* - In Mexico, for example, the incumbent administration adopted expansionary monetary and fiscal policy during the 1994 presidential elections. Moreover, the agreement between US and Mexico, which called for low trade barriers between the two countries, facilitated a boost in investor confidence leading to inflow of capital into Mexico and accumulation of foreign reserves. But one hand, deficit in the current account kept increasing in, while on the other hand, the GDP kept growing (with a couple of dips in between) in the early 1990s. Political instability, like violence in a region called Chiapas and the assassination of the President, led the investors to place an increased risk premium on Mexico's assets. The Mexican *Peso* had a crawling peg exchange rate system at that time. To maintain the peg, the Central Bank issued dollar denominated public debt for buying *pesos*. Under the election pressure, Mexico purchased its own treasury securities to maintain the money supply and hence, used its foreign reserves to buy *Pesos*. This resulted in depletion of the foreign reserves by the end of 1994. When the central bank devalued *Peso*, investors further increased the risk premium. The Central Bank then increased the interest rate to

[22] E. Kalter and A. Ribas, 'The 1994 Mexican Economic Crisis', IMF Working Paper, 1999, viewed on 27th August 2017, from https://www.imf.org/external/pubs/ft/wp/1999/wp99160.pdf

discourage the flight of the investors. However, soon Mexico faced a default, as it was unable to sell its bonds or securities, nor was it able to buy dollar in devalued *pesos*.

1997, Indonesia[23] *(Table 6.2)* – In 1997, Indonesia seemed far from crisis – had inflation in control, a trade surplus, high foreign exchange reserve and a stable banking sector. But a large number of Indonesian firms had borrowed in US dollars. Prior to 1997, Indonesian *rupiah* had strengthened respective to the US dollar, and the effective amount of loan was less for these Indonesian firms as the value of the local currency rose. When Thailand floated the *baht*, Indonesian *rupiah* came under severe speculative attack which culminated into a crisis. *Rupiah* was then allowed to float its value decreased. The firms that borrowed in US dollars found themselves in huge debt. Before the crisis, the exchange rate between *rupiah* and dollar was 2600 *rupiah* to 1 US dollar. The rate increased to around 14000 *rupiah* to 1 US dollar in January 1998.

1997, Thailand[24] *(Table 6.3)* - Thailand's economy was growing at an average of 9% during the early 1990s, the highest for any country at that time. The Thai *baht* was pegged at 25 to the US dollar. During May 1997, the Thai *baht* was hit by massive speculative attacks. The Prime Minister didn't want to devalue the currency, but Thailand lacked the foreign exchanges reserves to support the peg. Thailand was thus force to float the currency triggering a region wide crisis. Thailand's economy stopping growing, and the crisis resulted in massive lay-offs in finance, construction, real estate, and reverse migration of workers to rural areas.

1997, Korea[25] *(Table 6.4)* – Korea's conglomerates (also called chaebols) took huge bank loans to fund their expansion, but failed to make profits. This resulted in the burdening of the banking sector with non-performing loans. The Seoul Stock Exchange dropped by 7.2% in a single day in November 1997, and hence, excess debt eventually led to a crisis.

1998, Russia[26] *(Table 6.5)* – Fiscal imbalances (high budget deficit) and a high fixed exchange rate (floating peg) fuelled the 1998 Russian crisis. Russia also experienced a decrease in foreign exchange reserves as a result of the spill-over effects of the Asian financial crisis of 1997 and decline in exports (demand and price for crude oil and non-ferrous metal fell). The political instability and social unrest further led the investors to flee from Russia. The Russian government increased the interest rate to 150% on short-term government bonds in order to stop the capital outflow. Later in August, Russia devalued *ruble* and defaulted on domestic and foreign debt. The *ruble* was then allowed to float freely and it started to depreciate further. Inflation in Russia reached 84 percent in 1998.

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[23] C. Enoch, B. Baldwin, O Frécaut, A. Kovanen, 'Indonesia: Anatomy of a Banking Crisis', IMF Working Paper, 2001, viewed on 27th August 2017, from https://www.imf.org/external/pubs/ft/wp/2001/wp0152.pdf

[24] P. Bungarten, 'The Crisis of Thailand and the IMF', viewed on 27th August 2017, from http://library.fes.de/pdf-files/ipg/ipg-1999-3/artbungarten.pdf

[25] K. Kihwan, 'The 1997-90 Korean Financial Crisis, IMF website, viewed on 27th August 2017, from https://www.imf.org/external/np/seminars/eng/2006/cpem/pdf/kihwan.pdf

[26] J. Odling-Smee, 'The IMF and Russia in the 1990s', IMF Working Paper 2004, viewed on 27th August 2017, from https://www.imf.org/external/pubs/ft/wp/2004/wp04155.pdf

1998, Brazil[27] *(Table 6.6)* – Plano *real* was introduced in 1994 to curb the decades of inflation ranging from 100% to 2500% and to decrease public spending. According to this plan, *real* was reissued and pegged at 1 (crawling) to the US dollar in an attempt to stabilize the economy. Initially, *real* appreciated, but started to depreciate around 1999. Brazil, like Mexico, had high budget deficit and low foreign exchange reserves. The situation got worse due the Russia's 1998 economic crisis which led to more fear among the international investors. Between 1996 and 1998, Brazil's reserves dropped by $24 billion (around 40%) as most of it was used to buy *real* in order to stop it from depreciating.

1999, Argentina[28] *(Table 6.7)* – A fixed exchange rate (officially called the currency board convertibility regime) was adopted in 1991 to fight high rates of inflation. Extensive foreign and domestic borrowing from the government (leading to budget deficit), along with increased privatization, led to recession in mid 1990s. As the debt burden increased, crisis emerged.

2001, Turkey[29] *(Table 6.8)* – Following the capital account liberalization, Turkey experienced a boom-bust cycle with annual growth varying from 9.3 percent to -5.5 percent of GDP. Following liberalization, rising interest rates forced the government to borrow to meet the interest payments (which went up as high as 75% of tax revenue). The combination of high interest and inflation rates, open capital account, budget deficits resulted in crisis.

The IMF's approach: One-size-fits-all?

In Table 4, the comparison of the policies recommended by the IMF to the eight economies in crisis throws light on the IMF's tendency to push for tightening of fiscal and monetary policies. Typically, an IMF package involves fiscal consolidation, flexible exchange rate, and structural reforms like privatization, banking sector reforms and trade liberalization. This is also called the *one-size-fits-all* or the *blanket approach* wherein standard packages incorporating all these elements are implemented on every country that seeks the IMF's help in crisis.

But why is it problematic? If the problems are similar, then the solution to deal with it should also be similar. As stated earlier, almost all countries in our study, had a fiscal imbalance (budget deficit) and or had a fixed exchange rate (pegged to the US dollar). The fixed exchange rate had been adopted by various countries to fight inflation, and it worked out pretty well initially. Sometimes, it's even good to have a budget deficit wherein government spending plays a role in increasing the aggregate demand. But existing problems may aggravate when there is a large budget deficit coupled with low foreign reserves. A local currency pegged to the US dollar would require the country to hold large foreign exchange reserves. Large deficit may decrease investor's confidence in the economy and its ability to support the peg – triggering an increase in an outflow of capital because of the fear of devaluation of the local currency. So, it does make sense when IMF wants the government to exercise fiscal discipline

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[27] M. Evangelist, V. Sathe, 'Brazil's 1998-1999 currency ciris', University of Michigan website, viewed on 27th August 2017, from http://www-personal.umich.edu/~kathrynd/Brazil.w06.pdf

[28] T. Geithner, 'Lessons from crisis in Argentina, IMF website, viewed on 27th August 2017, from https://www.imf.org/external/np/pdr/lessons/100803.pdf

[29] 'Turkey's 2000-2001 Financial Crisis', Bank of Albania website, viewed on 27th August 2017, from https://www.bankofalbania.org/web/pub/turku_ang_230_1.pdf

when it's facing a deficit. The low exchange reserves typically arise when the government starts selling its securities in dollar denominated currency in order to fund its deficit, or it may choose to buy its own currency in order to maintain the pegged exchange rate system.

If we look at the major economic indicators in Table 5 and 6, we find that the countries did manage to come out of the crisis sooner or later, and as we have mentioned earlier, there are researchers who attribute this to the policies imposed by the IMF. But there's more than what meets the eye. The real issue here is about the appropriateness of the imposed policies. The right question to ask is are these bundled policies really necessary to tackle the crisis, and if they play a role in spreading the fire rather than putting it out.

The fiscal tightening and the monetarist approach of the IMF

The fundamental idea of fiscal tightening is that the country in crisis should give highest priority to paying off its external/international debt, and under monetary contraction, interest rates are increased to attract foreign investors so as to increase the inflow of capital. Typical fiscal and monetary tightening measures, like reduced money supply, decrease in wages, reduced government spending, increase in taxes, subsidies reversal, are advised by the IMF with the goal of establishing a 'balanced-budget foundation' for the long term economic growth. The contraction in money supply (aimed at curtailing inflation) and high interest rates (to stabilize the currency and attract foreign investment) often decreases local investment and consumption, and hence, reduces aggregate demand. The burden of local firms and banking institutions also gets increased due to the high interest rates. For instance, the IMF forced the Asian countries to soar interest rates so as to restore the investor confidence, but it failed to recognize the underlying weak banking system which was not capable to deal with the rapid flow of capitals in and out of the country. This further deepened the Asian financial crisis.

The counter argument to this is that lowering interest rates would increase the burden of external debts and would lead to deeper devaluation of the currency. But the problem arises when there are multiple problems at the same time. A policy of high interest rate coupled with decreased government spending causes financial problems to the local firms and banking institutions, and increases recessionary pressures, and hence, it gets difficult to maintain the confidence in local currency. When government stops spending, many investors pull out from the economy too. This was quite evident in the case of Korean crisis back in 1997, and recently during the 2013 Greece crisis. During the 1998 Argentina crisis, $1.6 billion was cut from the budget in the hope of increasing investor confidence and decreasing the interest rates. However, the investors saw this as a sign of worsening crisis, and began fleeing the market. In order to tackle the accruing budget deficit, more subsequent expenditure cuts were made by Argentina. These restrictive policies often neglect the need to develop the domestic base towards recover, stability and for future developments – including the encouragement of sufficient aggregate demand and the retention of the confidence of local savers, consumers and investors. In such cases, these policies have the potential to do more harm than good.

The social impact of fiscal austerity

Reducing social spending on healthcare, education and infrastructure development projects also pose challenges to the aspect of long-term economic progress. Decrease in the

government subsidies shoots up the price of amenities like food and fuel. Due to recessionary pressure, such policies lead to unemployment, loss of livelihood and income, reduced accessibility to goods and services, and an increase in poverty. All of these factors lead to social unrest, violence and riots deepening the crisis – which is what happened in Mexico, Indonesia, Russia and Argentina back in 1990s; and recently, the threat to livelihoods by the IMF imposed policies triggered riots and protests in Portugal, Spain and Greece.

Structural reforms and the 'neoliberal free market' approach of the IMF

The IMF maintains a strong stance for flexible exchange rate and free market reforms like trade liberalisation, privatization and openness in the capital account. Throughout the 1980s and 1990s, the IMF advised governments in low-income countries to liberalize their capital markets, and claimed that capital controls would hinder development. In contrast, countries like Britain, US and Western Europe made significant development not on the basis of 'free trade' but through government 'regulation of trade.'

The 1994 Mexican crisis saw rapid outflow of funds trigged by the contractionary fiscal and monetary policy and led to devaluation of the Mexican *peso*. This sudden withdrawal of foreign confidence threatened to put Mexico into default. In 1997, excessive reliance on the unregulated flow of capital into the economy, along a fixed exchange rate, pushed the Asian countries into crisis. When the foreign investors panicked about the overvaluation of the currency and the bank scandals, capital flight reversed and the economy collapsed. In 1996, capital worth $100 billion flew into the Asian economies, and it was flowing out at a similar rate in 1997. Under the bail-out package for these countries, the IMF focused on less critical issues like fiscal tightening and setting budget deficit targets, and did little to address the capital outflows and didn't provide enough funds to offset them either. Similarly, in early 1990s, the IMF asked the Kenyan Central Bank to remove controls over the flow of capital. This move backfired when corrupt politicians used it to transfer money out of the economy (known as the Goldenberg scandal).

Sometimes, these structural reforms recommended by the IMF, when implemented by the borrowing countries, can turn panic into fear. In 1996, the IMF announced sudden closure of banks amidst a Bulgarian banking crisis. Depositors panicked, withdrawals increased, the banks collapsed and it led to hyperinflation. Soon after this in 1997, during the Indonesia crisis, 16 banks were asked to get closed down by the IMF. These structural programs failed to restore the confidence. The closure of Indonesian banks triggered massive withdrawals from the banking system as the depositors worried that their banks too would be shut down. These examples show how the IMF failed to recognize the underlying social factors. Hence, one of the criticisms of the structural reforms is that it can be over-reaching – in other words, the critics argue that many of these structural reforms are not needed, and are forced on the struggling countries desperate for help. If these banking structural reforms had to be implemented, the IMF should have asked the government to take a proactive approach to reassure the depositors of the safety of their money in the bank, instead of triggering a panic.

Usage of capital and exchange rate controls allows a country to be in a better position to decrease the interest rate without worrying about the effects of a weakening currency and outflow of capital. This further allows the countries to go after stabilization of the economy through monetary and fiscal policies. However, exchange controls do present a lot of

problems and can be abused in a corrupt bureaucratic setting. Moreover, the neo-liberal conditions, like the IMF's push for trade liberalization and privatization, paves way for the MNCs to get a foothold in the emerging economies. When an economy is made more open, internationally operating firms typically buy the state-owned firms in low-income countries because they are able to quickly provide the much-needed capital. Even when the state-owned firms are acquired by local enterprises, the sphere of privatization increases and it can shift the focus towards 'efficiency' and to mass layoffs and social unrest.

It's critical to take a measured approach. The Asian countries, for example, took a careful pursuit of capital liberalization in order to manage the middle-income transition. For example, the Asian countries realized after the crisis that capital inflows into the economy can be a double-edged sword – especially the short-term inflows as opposed to FDIs. Although they provide relief to the financial constraints on the balance of payment, they can turn around quickly too. This highlights the importance of having a balanced mix and to have backup plans to deal with the sudden outflows of capital. In addition, the IMF, even today, fails to recognize that trade liberalization can work only under certain favourable conditions – like the ability of local firms to compete with cheaper imports, their production and distribution capacity, market accessibility, price factors etc. In the absence of positive factors, liberalization can lead to more problems.

Does the IMF bail-out of the rich private sector encourage risky behaviour?

The IMF was not the primary reason behind the financial crises in Mexico, Asia, Russia, Argentina and Brazil, but the crisis was a manifestation of poor domestic policies towards which the IMF contributed. The IMF lending often encourages the borrowing countries and the foreign investors to pursue risky behaviour, making them more vulnerable to crisis. This is called the *moral hazard*. For example, after the Mexican crisis in 1994, there wouldn't have been inflow of capital into Asia even at low interest rates if the investors didn't believe that the IMF would certainly intervene if things turned sour. Similarly, Argentina's economic policies in 1990s were developed under the direction of the IMF, and the IMF provided a loan of $3 billion dollars in 1998 and a loan of around $30 billion in 2010, assuring Argentina of its unwavering support. In 1995, the IMF and the US decided to bail out Mexico for the fourth time in 20 years. The loan was used by Mexico to pay off the investors, and the Mexicans themselves fell into debt and recession, signalling that the IMF would always come to investor's rescue. Though the private rich investors are bailed out by the IMF, the burden is then passed on the common man of the borrowing country to pay back the loans.

In the absence of the IMF intervention, the creditors and debtors would be forced to renegotiate the loans and the borrowing country would enter into bankruptcy procedures. The investors would then be careful about their investments in the future, and the borrowing country would also react differently rather than anticipating IMF's help. This suggests that IMF intervention often overrides the market mechanism. Moreover, as the borrowing countries fail to meet the fiscal targets conditioned by the IMF, they stop receiving support monetary support amidst the transformation.

Does the IMF push for policies and loans that eventually favours the US?

As implied earlier, the conditions imposed by the IMF are said to serve the interests of the US and other developed capital countries, owing to the fact that US holds the largest quota in

the IMF. The neo-liberal policies recommended by the IMF also support the argument of *Washington Consensus*. In this way, the IMF allows the US and other countries to force their own agenda by leveraging the troubled economies through conditional loans. One of the reasons that the IMF and the US decided to give loans to Mexico was political in nature. Because of NAFTA, US was tied in a relationship with Mexico and hence, wanted the Mexican economy to stabilize. The low-income country Haiti continued receiving loans from the IMF during the Cold War era when Haiti was strategically important for the US. Pakistan received a loan from the IMF in 2001 (which was double the amount of their previous loans) from the IMF. One could argue that Pakistan was of political interest to the US because of its position in the UN Security Council, and also because the US was trying to get a foothold in Afghanistan.

Another example is the conflict between the US and Asian countries that arose with Asia's proposal of an Asian Monetary Fund (AMF) in 1997 in an attempt to build a regional institutional backup. The Asian government was quite sceptical of the competency of the IMF to handle the crisis and were unhappy with the strict conditions attached to the loan. Though the creation of AMF failed then, a new institution called Asian Infrastructure Investment Bank was formed in 2016 through support from China and other 56 other Asia-Pacific member countries. As the IMF is dominated by the Western powers, most of the emerging economies today are developing models of pooled-alliance. Instead of turning to IMF for help, the focus of these emerging economies is to pool the local and international reserves - which serves as the credit line for development projects as well as in case of emergencies. BRICS countries, for example, created the New Development Bank based on this model wherein the regional powers would have a greater say on various issues related to them. As far as loans to the poorer countries are concerned, not many of these countries have become richer even after the continuous IMF support. One would argue that the IMF is not a charitable organization, but giving out loans instead of 'aid' to the poor and low-income countries often pushes them into a cycle of debt and poverty.

Do the IMF prescribed policies hurt or help the ordinary people and the poor?

As mentioned earlier, the fiscal tightening policies proposed by the IMF often have social implications – loss of income, decrease in subsidies, negative effect on health care etc. Another issue related to tightening policies and structural reforms is the IMF's preference to bail out the private sector without paying much heed to the public. The rich creditors get bailed out by the IMF, while the poor and the ordinary are burdened to pay back the loans. The IMF bail-outs, in a way, lead to privatization of the investors' profits and socialization of the investors' losses – placing the social risk of the troubled economy and the private risks of the foreign investors in the same equation. This sparks outrage from the local citizens of the country and often leads to public outcry in the form of violence, riots, damage to property and loss of lives.

Mass anti-austerity protests by the local community -- During the 1990s and early 2000s, the IMF was at the receiving end of the protests by the local community. The cases of Argentinian and Indonesian protests have been discussed later in this study. Recently, there have been numerous such instances of massive protests of the IMF policies. In 2011, around 3,00,000 Greeks protested the austerity measures of the IMF, while similar mass scale protests were organized in Spain and Ireland. UK, when the education spending and tuition assistance was

cut down by 80% on recommendation of the IMF in 2010, around 50,000 protestors, mostly students, resorted to violence and vandalism. The number of such protests have risen in the last decade.

Over-reaching IMF conditions -- Many of the reforms advised by the IMF are criticized for being far from its field of expertise. Despite political opposition to privatize the cotton sector in Mali, the IMF went ahead with its reforms in 2005 which tied cotton prices to the world market values - and led to disastrous consequences for the poor cotton farmers because cotton was heavily subsidized in the developed economies. This also affected Mali's poverty reduction strategies in a negative way. In another similar case, the IMF backed the privatization of the copper mining sector and introduced fiscal reforms in 1995 to attract foreign/multinational corporations. The investor friendly regime significantly decreased government's share of the revenue and increased the foreign investors' chunk of profits. In yet another example of privatization reforms by the IMF, Cameroon's aviation sector suffered heavy losses after being privatized in the absence of a good regulatory framework and adequate governance standards. In Tanzania, the IMF asked the government to sell their stakes in industries to the private firms, reduce trade barriers and to cut down on government spending in 2000. Due to this, patients had to pay for healthcare (despite high AIDS rate) that was previously free of charge. Budget cuts were made in the education sector as well due to which the school enrolment ratio declined from 80% to 66% and the illiteracy rate increased to roughly 50%.

Push for structural reforms at the expense of the poor -- To increase privatisation and exports, tax breaks and subsidies are given to the export industries; while to achieve fiscal targets, subsidies are reduced and the taxes are increased for the local tax payers. For example, in 1990s, the IMF prohibited Haiti from subsidizing its farmers, and at the same time, asked Haiti to open its market so as to import the highly-subsidized US rice. The structural reforms imposed by the IMF included a reduction in import tariff from 50% to 3%. As a result of this, almost 80% of rice in Haiti today gets imported from the US despite the fact that almost 70% of Haitian working population are farmers. Hence, the local Haitian farmers were forced to sell off their land, and to seek work in sweatshops. The poor became poorer – resulting in greater poverty and food insecurity in Haiti. Many of the structural reforms prescribed by the IMF involve changes in the labour laws - like lowering of wages and elimination of the collective bargaining. This is done to attract the foreign investors. The IMF's approach of 'labour flexibility' also allows the foreign corporations to move where wages are the cheapest. For example, during the late 1990s, Haiti was asked by the IMF to decrease the wages even when the inflation kept rising.

Malaysia – the country that took the anti-IMF route during the 1997 crisis

The Malaysian experience, during the Asian Financial Crisis, also gives insights into how the IMF can go wrong. Malaysia took many anti-IMF steps in its approach to cope with the 1997 crisis and yet managed to do well. During the Asian crisis, Malaysia refused the IMF's loans. However, during the first year of the crisis, Malaysia initially implemented policies similar to ones recommended by the IMF – contractionary fiscal and monetary policy, trade liberalization, open capital accounts and flexible exchange rates. Soon after, its currency and stock market went down, bank struggled with non-performing loans and the economy further went into deep recession. In September 1998, a new policy was adopted by Malaysia -

expansionary fiscal and monetary policies, and *ringgit* currency was pegged to US dollar. This stopped overseas trade of *ringgit* (de-internationalization) and prevented speculative attacks. Other measures included selective capital controls with open capital accounts; reduction of interest rates, along with restructuring bad corporate and banking loans. Soon, Malaysia began showing signs of recovery despite doing opposite of what the IMF usually asks.

Jordan – Success story of the IMFs during the 1990s

Though the effects of the IMF's *blanket approach* have been debatable in the countries that we have analysed so far, the IMF programs have been quite successful in getting Jordan out of the Gulf crisis in 1990s. In 1970s, Jordan's economy primarily relied on remittances from Jordanian labourers in the neighbouring Gulf countries (contributing to 20 percent of GDP), exports, and aid provided by the countries in the region. In late 1980s, falling oil-prices and regional economic recession negatively affected the inflow of official transfers and remittances. The Jordanian authorities initially resorted to external borrowing to finance its budgetary requirements. This led to a sharp increase in external debt. In 1989, Jordan was struggling with 30-35 percent unemployment rate, while the deep-rooted structural deficiencies made it difficult for Jordan to pay back its debt. Moreover, Jordan's opposition to the Gulf war of 1991 led to the termination of aid from the regional countries and the Jordanian workers were expelled, further aggravating the issue.

Between 1992 and 1999, IMF agreed to provide three different fund-facility loans[30]. As per the conditionality imposed on the loans by the IMF, Jordan was required to boost domestic savings, increase investments, and undertake rapid structural reforms in financial sectors, trade, privatization and regulatory frameworks. In 2000, Jordan became a part of WTO and soon after, entered into a Free Trade Agreement with the US. What separates the case of Jordan from other countries is the fact that though the intermediate objectives of the IMF programs were related to specific fiscal targets like higher real GDP growth and inflation, the IMF programs became linked to Jordanian government's social policy objectives over time. Jordan was minimally affected by the 2008 financial crisis. In fact, as a response to the recession, the government engaged in several infrastructure projects through public-private partnerships and continued its progress in enhancing the investment climate. The IMF programs were able to provide a strong foundation for Jordan to tackle the negative impacts of regional and global events.

A closer look at three different economies in crisis

Mexico – The Mexican *Peso* Crisis of 1994

After struggling during the lost decades of the 1980s, Mexico seemed to be in a healthy position in the early 1990s. Inflation was under control, foreign investments were growing, and there was accumulation of billions of dollars in reserves. In 1993, investors got almost 100% returns on purchase of certain Mexican bonds, thus, there was an increase in the demand for Mexican assets. In 1994, Mexico entered into a trade agreement (called NAFTA) with the US to further encourage foreign investment. Mexico saw an inflow of foreign money

[30] 'IMF Support to Jordan, 1989-2004', Evaluation Report, Independent Evaluation Office, IMF website, viewed on 27th August 2017, from http://www.imf.org/External/NP/ieo/2005/jor/eng/pdf/report.pdf

(as high as $91 billion) through the capital account during this period. Mexico was pegged to the US dollar at that time, and to maintain the peg, Mexican government used the large foreign reserves to buy *pesos* whenever its supply increased its demand.

There were three major events that pushed Mexico into crisis in 1994 – growing current account deficit, outflow of foreign capital and the political unrest. The current account deficit almost quadrupled within three years - $6 billion in 1989 to around $24 billion in 1993. The relative inflation rates for Mexico was higher than the US. This resulted in expensive domestic goods (increase in price due to inflation) for the Mexicans while the US goods had a fixed price because of the pegged exchange rate. In other words, Mexican consumers enjoyed an increase in their purchasing power as the real exchange rate increased while the nominal exchange rate was fixed. The high value of Mexican *peso* against the US dollar triggered an import of subsidized goods from the US, further increasing the current account deficit.

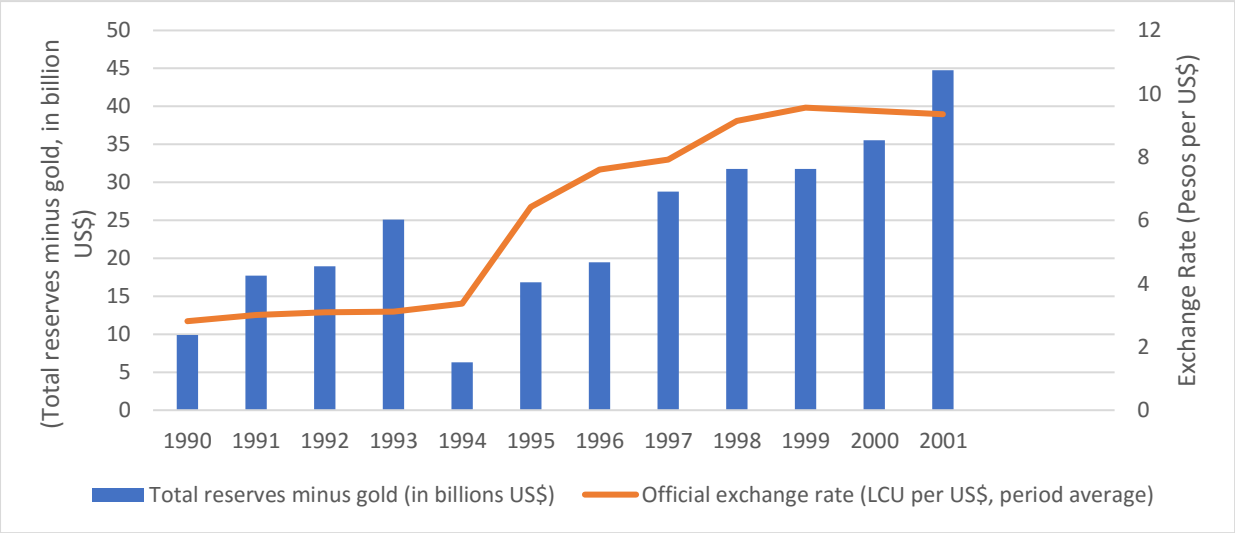

Table 7.1***[31] – Mexico's depleting reserves to support the pegged exchange rate in 1994

Because of the presidential election pressure in 1994, the government adopted expansionary policies - increased money supply, increased deficit spending and tried to maintain the overvalued *Peso*'s peg to the US dollar. Apart from using international reserves to buy *pesos* in the forex market, the Mexican central bank also issued new short-term US dollar denominated debt instruments. Subsequently, Mexico used the borrowed dollar to buy *pesos* in order to increase its demand and to maintain the peg. The Mexican government issued nearly $30 billion in short-term treasury bills (called *tesobonos*) to finance this expansion. The violent Chiapas conflict of 1994 and the assassination of candidate Colosio lowered the confidence of investors resulting in capital flight. Moreover, an increase in interest rates in the US later resulted in abrupt outflow of foreign investment and domestic savings.

[31] ***World Bank country specific data, viewed on 27th August 2017, from http://databank.worldbank.org/data

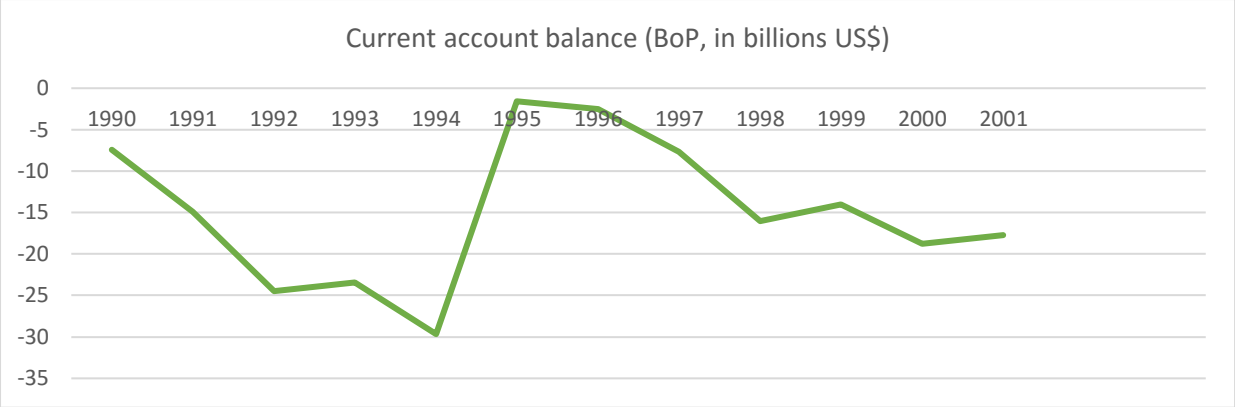

Table 7.2*** – Mexico's increasing current account deficit financed through external loans

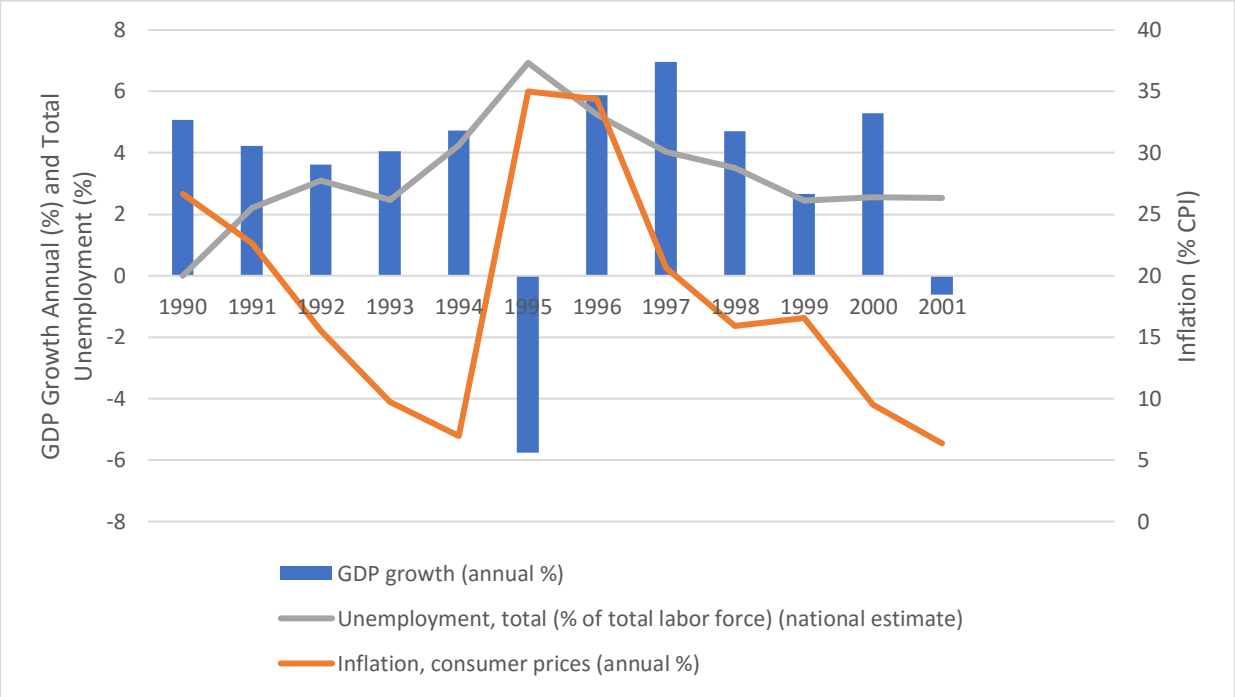

Table 7.3*** – Mexico's macroeconomic indicators

The economic and political shocks caused Mexican *pesos* to flee the economy and the foreign exchange market saw an increase in supply of *pesos* while its demand plummeted. When the foreign reserves nearly depleted and the downward pressure on *peso* increased, President Zedillo had to float the *peso* and thus, *peso* depreciated. The devaluation of *Peso* made the currency cheaper – which also meant that imports were costlier and exports were cheaper. This led to increase in price of imported goods used for production - which in turn led to the increase in price of final domestic goods. This led to inflation which rose to about 50%. As Mexico was deep in liabilities with a soaring domestic inflation, it turned to the IMF for help.

Role of the IMF in Mexico

Moral Hazard

The 1995 IMF loan package provided $18 billion to Mexico and it essentially helped in rescuing the 'foreign investors' who had invested in the short-term Mexican bonds. This is one of the biggest bail-outs of the IMF during those times, and it signalled to the all the investors that

the IMF would be there to bail them out, and hence, encouraged riskier global investments. The result was the Asian Financial Crisis of 1997 which was also trigged due to rapid foreign capital inflows of about $90 billion followed by its sudden withdrawals. The readiness of the IMF to bail out the foreign investors creates moral hazard and allows them to behave recklessly. If these financial institutions had suffered losses in Mexico, they would have made prudent investments decisions and would have been more cautious while investing in the Asian Countries.

Political interests of US in Mexico

Mexico has been one of the frequent borrowers from the IMF. The 1994 bailout by IMF is one of the largest ones in terms of monetary assistance, and one could argue that these bailouts were given a green signal because it was in the interest of US to stabilize the Mexican economy. As Mexico had entered into the trade agreement (NAFTA) with the US, US had political and economic interests in Mexico. Because of the highest voting power of the US (owing to its largest quota) in the IMF decision making process, the IMF was bound to bail out Mexico.

Rich bailed-out, poor left to pay back the loan

Because of its narrow focus on the balance of payments, the IMF programs in Mexico required the Mexican government to primarily focus on reducing their budget deficit first. One of the IMF conditions imposed on Mexico was to increase taxes, and hence, Mexico's taxpayers were required to pay more taxes to pay back the IMF loans. The standard of living saw a sharp decline during this period. Fiscal austerity measures, imposed by the IMF, deepened and prolonged the recessionary period affecting the poor. Though the IMF's intervention bailed out the international investors, it didn't really bail out the citizens of Mexico. The investors suffered little or no loss, while they passed this on to the ordinary and poor Mexican in the form of a larger debt.

Mexico after the IMF bail- out

We saw that privatization, financial liberalization and deregulation reforms undertaken by Mexico during the 1980s and early 1990s had dramatically increased lending activities and the inflow of foreign capital into Mexico. Ironically, all these reforms are promoted by the IMF and are part of a typical IMF conditionality. This suggests that the IMF prescribed policies can lead to crisis. Without the IMF intervention in 1994, Mexico would have probably negotiated with the debt holders and would have been forced to sell its assets in order to pay back the loans. This could have alarmed the investors investing in the Asian economies as well. Though Mexico's economy did stabilize after 1997, its economic and political ties with US led to adverse effects during the 2008 global crisis.

Indonesia - Asian Financial Crisis, 1997

The Asian Financial Crisis began when the flow of foreign capital into the Asian economies got reversed as investors lost confidence in the Southeast Asian countries to maintain their fixed exchange rate with their increasing current account deficit. South East Asian countries relied on pegged exchange rate during the 1980s and early 1990s for their economic growth. The underlying factors for the Asian crisis were similar to that of Mexico. During the mid 1990s, devaluation of Chinese *renminbi* and Japanese *Yen* occurred along with the rise in the US

interest rates – which diverted the flow of capital towards the US from the Southeast Asia, and raised the value of the US dollar.

As the Southeast Asian economies had pegged their currencies to the US dollar, their exports became more expensive due the higher valuation of the US dollar. This further increased the current account deficit. Moreover, political affairs, like the transfer of sovereignty over Hong Kong from UK to China in 1997, caused uncertainty among the investors. Amidst panic and fear, the investors started withdrawing their money and the supply of the currencies of the South Asian countries increased in the exchange market - putting downward pressure on their respective exchange rates. To prevent the flight of capital, the governments started increasing domestic interest rates and to maintain the peg, they used foreign reserves to buy excess domestic currency.

Indonesia – caught in the contagion?

Indonesia seemed to be doing better than the rest of the Southeast Asian countries in June 1997. It had low inflation, high foreign reserves and a trade surplus. But a large number of private firms in Indonesia had been borrowing externally in US dollars. Before the crisis, Indonesian *rupiah* was stronger than the US dollar and hence, the effective level of debt of these private firms had decreased. Though Indonesia maintain a pegged float exchange rate, *rupiah* came under severe speculative attack because of the withdrawal of funds from its neighbouring countries. The *rupiah* was forced to float freely and it dropped further. The exchange rate was roughly 2600 *rupiah* to 1 US dollar before the crisis, and it increased to over 14000 *rupiah* to 1 US dollar during July 1998. The rapid selling of rupiah by the Indonesia firms revealed the underestimated massive foreign debts and the underlying structural weaknesses in their banking sector.

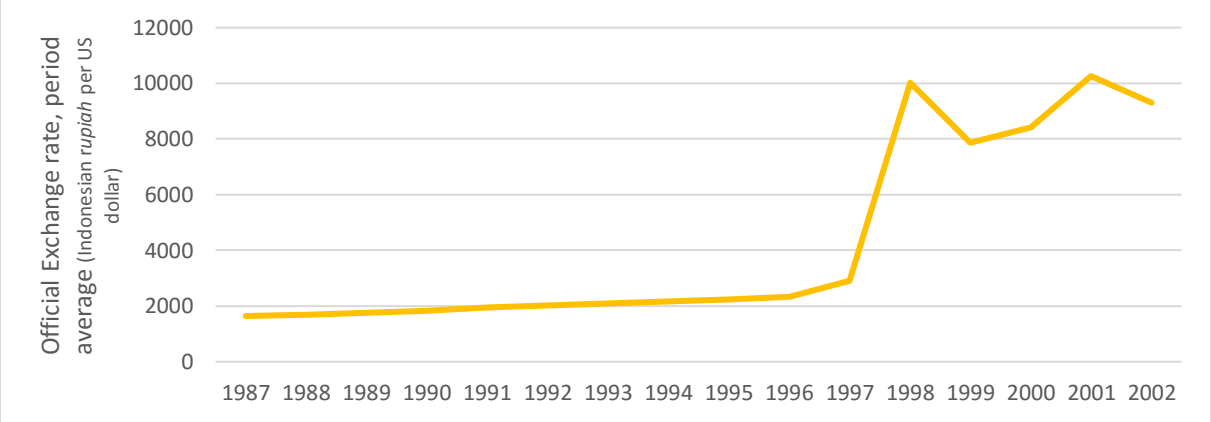

Table 8.1*** – Indonesia adopted a pegged exchange rate in 1980s and 1990s to fuel economic growth

Role of the IMF in Indonesia

The IMF program of $43 billion was conditioned on various reforms like monetary contraction, closure of 16 private banks, decrease in food and energy subsidies, and the rise of interest rates to attract investors. The interbank rate soared from 20% to 300% and this lead to liquidity crunch. The closure of banks triggered panic among the depositors of other banks and they started withdrawing their money from their savings accounts – leading to shortage of credit in the market. The domestic Indonesian firms were hit with dual blow of

high interest rates and devalued currency. This resulted in massive bankruptcy and unemployment – thousands of people lost their jobs.

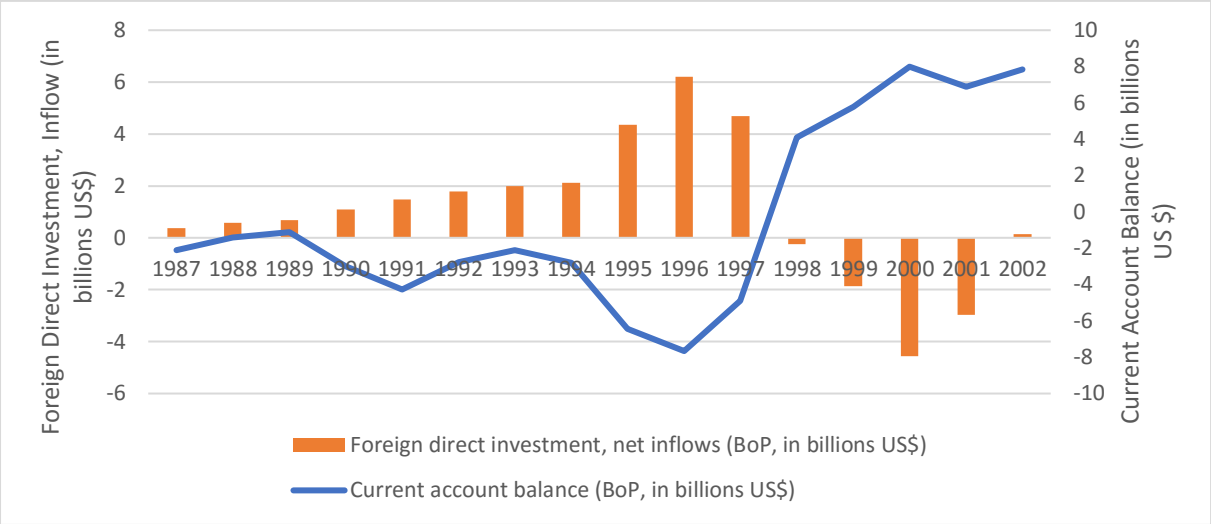

Table 8.2*** – Increasing inflow of capital into Indonesia during 1990s while it was struggling with a current account deficit

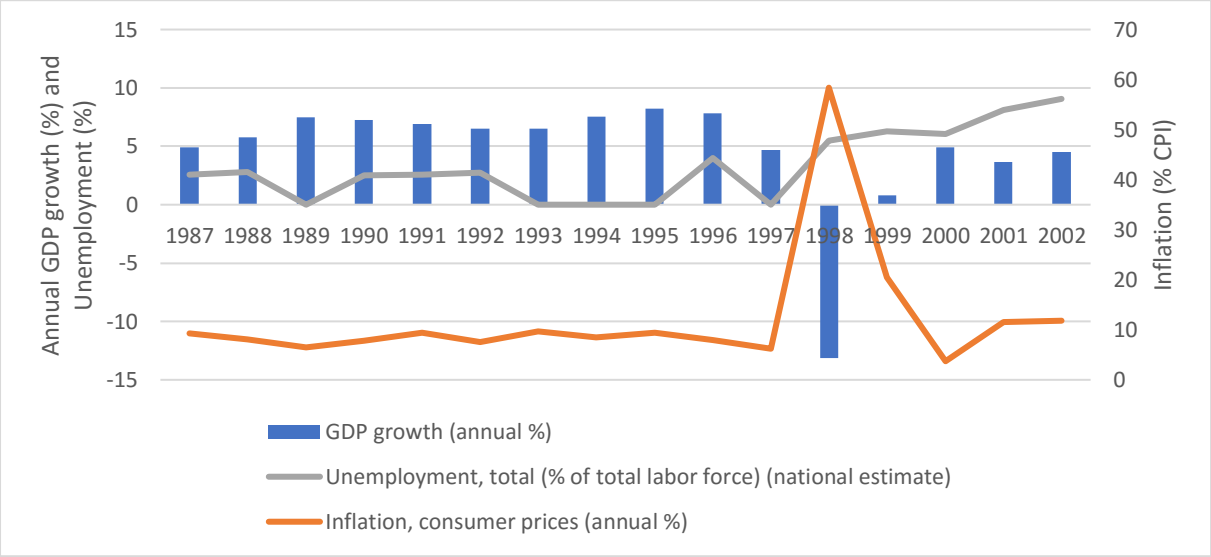

Table 8.3*** – Indonesia's major macroeconomic indicators during the period of crisis

Transferring private debt burden to public's shoulders

Under the IMF policies, Indonesia's private debt was converted to public debt, and the increased debt burden fell on the ordinary Indonesian citizens to pay back. Due to fiscal deficit and the growing debt, Indonesia was required to increase taxes, decrease subsidies, increase electricity and fuel rates, and decrease subsidies. The IMF also failed to take into account the political corruption (which was the result of President Suharto's patronage) that was rampant throughout Indonesia and didn't take any measures to address this particular issue. Because of the political uncertainties associated with President Suharto (as he was ill at that time), the investors kept withdrawing capital. On one hand, the IMF was trying to push too many

reforms in a small period of time, while on the other hand, the incumbent Suharto government was reluctant to implement most of these.

IMF's failure to recognize the brewing social and political storm

In addition, Indonesia was hit by an El-Niño drought and food production took a hit. As the IMF had imposed decrease in food subsidies, people started to hoard food. Inflation, food shortages and unemployment deteriorated conditions and brought many under poverty. Soon, the financial crisis grew into a massive social and political storm. Local demonstrations and criticisms against the corrupt Suharto government grew. When the subsidies on fuel and food were reduced, large scale riots broke out in Solo, Jakarta and Medan. Four Indonesian students were killed during University protests, triggering more riots. People from Chinese ethnicities were also targeted during these riots – as Chinese were assumed to be wealthier. Houses were burned down, while many were raped and murdered and thousands lost their lives. After all this, Suharto was forced to step down, but the damage was already done.

Indonesia after the IMF bail-out

Indonesia's crisis worsened even after the IMF's intervention because of three main reasons – excessive reliance on hot money (result of moral hazard created by the IMF lending), weak financial sector, and corrupt political environment (government not willing to implement the reforms and the political uncertainty led to reversal of capital flows). Though structural reforms in the banking sector were a welcome move, the IMF's failure to diagnose the prevailing social and political conditions aggravated the crisis - as Indonesia didn't have the required ecosystem to implement those reforms. However, soon after Suharto's fall, Indonesia began showing signs of recovery.

Argentina – The 1998-2002 Argentine Great Depression

To fight inflation (of about 3000%) and low productivity in early 1990s, the Argentinian Currency Board pegged the Argentinian *peso* to the US dollar through the Convertibility Plan. This ensured that Argentinian *pesos* could be freely converted to US dollars at the banks, and hence, the central bank was required to keep an international reserve equivalent to the cash in circulation. When dollar strengthened in relation to other currencies, Argentinian *peso* also began to appreciate. This made imports cheaper, and helped in curbing the inflation. However, a stronger dollar (and hence, a stronger *peso*) began to hurt Argentinian exports and this later led to an economic downturn – GDP either didn't grow or declined because of the fall in exports. Increasing imports and low exports created a balance of payment problem.

The regional economic shocks during the late 1990s in Mexico and Brazil further harmed Argentinian exports. The convertibility plan had also decreased the cost of borrowing as investors could readily convert *pesos* to US dollars. At the same time, the government ran significant fiscal deficits. The deficit and the currency peg was financed through borrowings from the IMF and the external lenders. Though running a budget deficit is not inherently bad, but because of the stagnant growth, the debt kept increasing and the ability of Argentina to pay back the loans decreased. Defaults on growing external debt, unemployment and inflation increased leading a crisis and eventual abandonment of the Convertibility Plan. The crisis resulted in poverty for millions of Argentines leading to political chaos and social unrest.

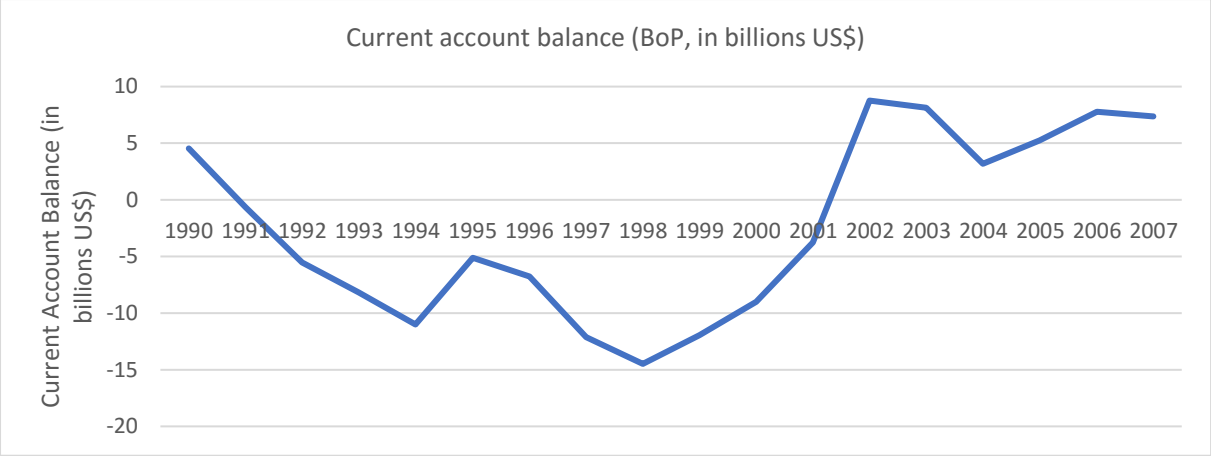

Table 9.1*** – Indonesia's ran a current account deficit through growing external debt.

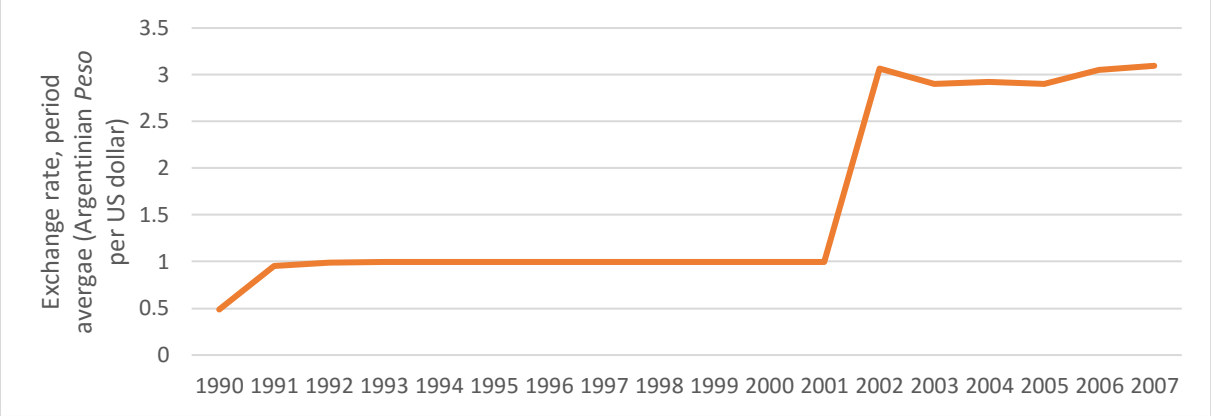

Table 9.2*** – The Convertibility Plan pegged the Argentinian currency to the US dollar

Role of the IMF in Argentina

Did the IMF push Argentina into crisis?

During the early 1990s, as per the IMF's advice, Argentina began to adopt the IMF formula of *Washington Consensus* to fight inflation – reducing budget deficit, increasing interest rates, privatization, regulation of capital flows, decrease in trade barriers. In late 1990s, Argentina entered into a growing recession and the external debt soared, but the IMF continued to insist on fiscal austerity measures to sustain investor confidence. These IMF formulae often stood in the way of social equity and clashed with the incumbent government's plans. Decreased government spending, increase in taxes, decrease in subsidies, and cuts in salaries and retirement benefits led to public discontent. The crisis grew when the IMF refused to provide further loans to Argentina in December 2001 because of its failure to meet budget deficit targets, and IMF further demanded more budget cuts. Investors panicked and people began to withdraw money from bank account (used the convertibility plan to convert *pesos* to dollars) and sent it abroad leading to a banking crisis. As the crisis peaked, millions became homeless and jobless. The government's decision to freeze spending sparked violent protests across Indonesia. The 2001 Argentinian riots saw loss of lives and destruction of private property and soon, the President resigned.

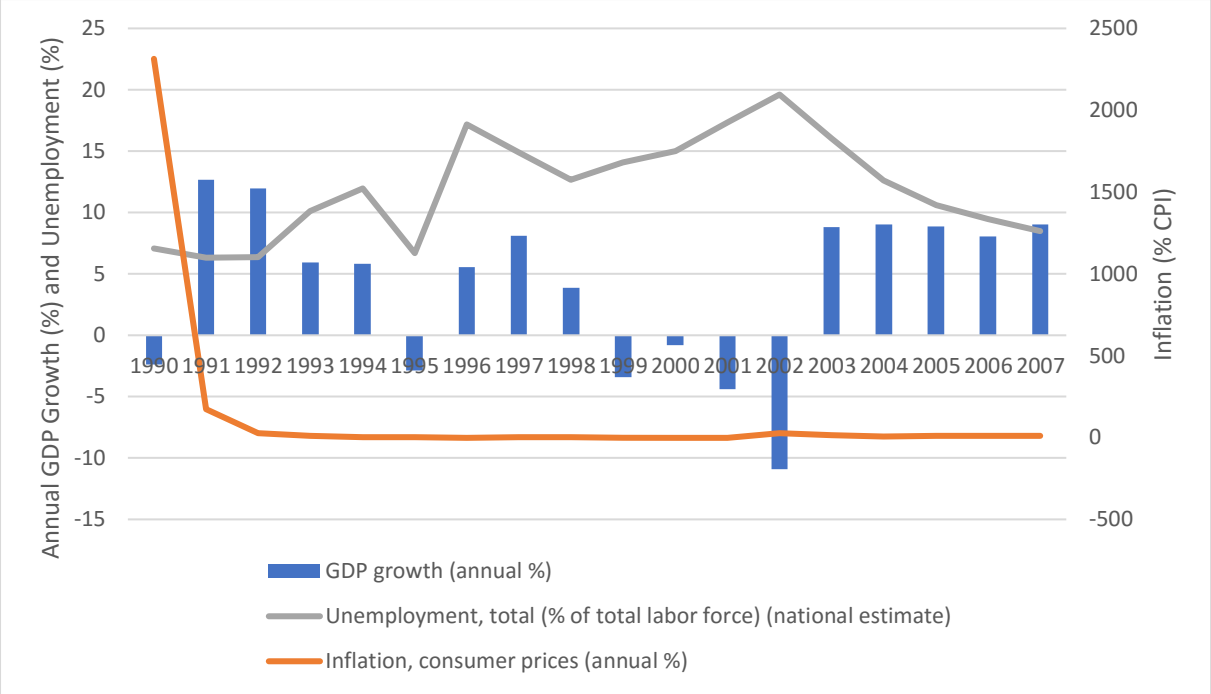

Table 9.3*** – Argentina's major macroeconomic indicators during the crisis

Argentina after the IMF intervention

As the crisis in Argentina grew, abandonment of the currency board or renegotiation of the external debt, or both was needed. IMF's failure to take the underlying factors into consideration, its inability to devise an exit strategy and its reluctance to provide loans when Argentina was at the peak of its crisis indeed worsened the situation.

Conclusion

Most of our analysis revolved around the appropriateness of the IMF conditions imposed on the borrowing countries. One of the issues that stood out is the IMF's failure to recognize the underlying social and political factors prevalent in the borrowing counties, and its tendency to prescribe the same sets of IMF policies that have worked in a different context. The *one-size-fits-all* approach either led to unintended political and social repercussions in the borrowing countries, or it deteriorated the already brewing socio-political crisis.

The crisis, in most of the borrowing countries, emerged due to a combination of current account deficits (balance of payment), capital flight reversal due to loss of investors' confidence, and/or depleting forex reserves and the country's inability to support a fixed exchange rate system. The typical IMF conditionality is primarily aimed towards restoring the balance of payment through fiscal austerity and monetary contraction. But the IMF prescribed policies do little or nothing to address other important social and political issues. Moreover, fiscal tightening causes social dilemma for the borrowing country, and tightening monetary policies can increase the burden on the local banking sector. When the crisis occurs, the IMF interventions save the international private investors and put the burden of the IMF debt on the local poor and ordinary citizens. The *moral hazard* argument suggests that the IMF loans continue to encourage this reckless and risky behavior from the private investors.

And repeated borrowings suggest that the IMF borrowing are more of a dependency rather than a one-time-thing.

When the borrowing country is then forced to undertake contractionary fiscal policies, the social programs take a hit and the poor suffer again. The social conditions and the political unrest surrounding the borrowing country often deteriorate due to the imposed conditionality – leading to violence and loss of lives. Riots and protests don't stabilize the economy, it would rather scare the investors away, and the country would find itself in a deeper mess. Also, shouldn't the government be allowed to help out the poor first in the face of a crisis? Instead of fiscal austerity measures, shouldn't the government be allowed to spend more? This would help in increasing the investors' confidence in the struggling economy. There is indeed a need for the IMF to take the economically disadvantaged into consideration while designing the policies.

We don't mean to insinuate that all of the IMF conditionality policies were bad for the borrowing country. For example, the exchange rate system prescribed by the IMF did help in the long run. And there is no denying the fact many of these distressed economies were in a dire need of structural reforms in various sectors like banking and regulation. The problems arise when the IMF tries to implement many policies at once, and in the process, it either loses focus on the real issue that led to the crisis, or it leads to more social problems for the borrowing countries. Often the IMF policies fail because of the reluctance of the borrowing country to implement those reforms. The reasons could be many – ranging from local protests to corruption. A few of the IMF structural reforms backfired because of the absence of a stable environment to support those reforms. The IMF is also fixated on one formula for growth – free and open market and the superiority of the private sector. The IMF's push for the structural reforms through free market principle (trade liberalization and privatization) is in contrast with the approach of several big economies like US, UK, Western Europe wherein development was based on the foundation of regulated trade and banking. Moreover, these structural reforms are often carried out keeping the investors' and external entities' interests in mind and this again hurts the local workers of the borrowing country. Some regulation of the foreign investment is indeed needed to balance the social risk with the private risk.

As the per IMF website[32], one of its jobs is to vigilantly monitor and identify the growth risks across the economies. However, considering the negligence of the social and political context of the distressed economies, one could argue that there is room for improvement in the IMF's pre- and post-crisis surveillance, and a need to align its conditionality with the socio-political conditions of the borrowing countries.

[32] What the IMF Does, IMF Website, viewed on 27th August 2017 from https://www.imf.org/external/work.htm