

This PDF is a selection from a published volume from the
National Bureau of Economic Research

Volume Title: Economic and Financial Crises in Emerging
Market Economies

Volume Author/Editor: Martin Feldstein, editor

Volume Publisher: University of Chicago Press

Volume ISBN: 0-226-24109-2

Volume URL: <http://www.nber.org/books/feld03-1>

Conference Date: October 19-21, 2000

Publication Date: January 2003

Title: IMF Structural Programs

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URL: <http://www.nber.org/chapters/c9778>

IMF Structural Programs

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IMF Structural Programs

5.1.1 Introduction

“Detailed conditionality (often including dozens of conditions) has burdened IMF programs in recent years and made such programs unwieldy, highly conflictive, time consuming to negotiate, and often ineffectual.”

“The IMF [International Monetary Fund] should cease lending to countries for long-term development assistance (as in sub-Saharan Africa) and for long-term structural transformation (as in post-Communist transition economies). . . . The current practice of extending long-term loans in exchange for member countries’ agreeing to conditions set by the IMF should end.”

—*Meltzer Report* (International Financial Institution Advisory Commission 2000, 7, 8, and 43)

“Both the Fund and the Bank have tried to do too much in recent years, and they have lost sight of their respective strengths. They both need to return to basics . . . [The Fund] should focus on a leaner agenda of monetary, fiscal, and

The author is grateful to Masood Ahmed, Mark Allen, Caroline Atkinson, Fred Bergsten, Barry Eichengreen, Martin Feldstein, Timothy F. Geithner, Stefan Ingves, Paul Keating, Mohsin Khan, Robert Lafrance, Carl Lindgren, Robert Litan, Michael Mussa, Yung Chul Park, Jacques Polak, James Powell, Miguel Savastano, Todd Stewart, Ohno Wijnholds, John Williamson, and Yukio Yoshimura for helpful comments on an earlier draft, and to Trond Augdal for superb research assistance. He also wants to thank Stanley Fischer and his colleagues at the International Monetary Fund for sharing with him the fund’s data on structural conditions in fund programs.

exchange rate policies, and of banking and financial-sector surveillance and reform.”

—*Council on Foreign Relations Task Force* (1999, 18–19)

“The one common theme that runs through perceptions of ESAF [Enhanced Structural Adjustment Facility] at the country level is a feeling of a loss of control over the policy content and the pace of implementation of reform programs.”¹

—*External Evaluation of the ESAF* (Botchway et al. 1998, 20)

“The IMF should eschew the temptation to use currency crises as an opportunity to force fundamental structural and institutional reforms on countries, however useful they may be in the long term, unless they are absolutely necessary to revive access to international funds.”

—Martin Feldstein (1998, 32)

“The IMF’s activities are not related to those specified in its charter for the simple reason that the par-value system of exchange rates it was to monitor no longer exists. In the tradition of skilled bureaucracies, the IMF has turned to new areas and has managed to expand substantially its financial resources and, in the process, its influence.”

—George Shultz (1995, 5)

“The IMF has not been established to give guidance on social and political priorities, nor has its voting system been designed to give it the moral authority to oversee priorities of a noneconomic nature. Its functions have to be kept narrowly technical . . . and the Fund has to accept that the authorities of a country are the sole judges of its social and political priorities.”

—David Finch (1983, 77–78)²

“The IMF programs in East Asia are far from optimal for restoring financial market confidence in the short term. . . . [T]hey have covered a very wide range of policies beyond the immediate financial crisis. . . . Most of the structural reforms, however, simply detract attention from the financial crisis. They have taken government expertise, negotiating time, and political capital away from the core issues of financial markets, exchange rate policy, and the like.”

—Steven Radelet and Jeffrey D. Sachs (1998, 67–68)

“In view of the size of the current deficits and the difficulties that may arise in private intermediation, the Fund must be prepared, when necessary, to lend in larger amounts than in the past. Also, the structural problems faced by many countries may require that adjustment take place over a longer period than has been typical in the framework of Fund programs in the past.”

—International Monetary Fund (IMF), *World Economic Outlook* (1980)

1. ESAF is the Fund’s Enhanced Structural Adjustment Facility, established in 1987 to provide long-term concessional assistance to low-income countries facing protracted balance-of-payments problems.

2. Mr. Finch was then the director of the IMF’s Exchange and Trade Relations Department.

“The Fund approach to adjustment has had severe economic costs for many of these [developing] countries in terms of declines in the levels of output and growth rates, reductions in employment and adverse effects on income distribution.”

—*Report by the Group of Twenty-Four* (1987, 9)

“Our prime objective is growth. In my view, there is no longer any ambiguity about this. It is towards growth that our programs and their conditionality are aimed.”

“Only the pursuit of ‘high-quality’ growth is worth the effort. What is such growth? It is growth that can be sustained over time without causing domestic and external financial imbalance; growth that has the human person at its center . . . growth that, to be sustainable, is based on a continuous effort for more equity, poverty alleviation, and empowerment of poor people; and growth that promotes protection of the environment, and respect for national cultural values. This is what our programs are, more and more, and must aim for.”

—From speeches by former IMF Managing Director Michel Camdessus (1990, 2000a, respectively)

“In recent years, some critics of the IMF have gone to the opposite extreme, arguing that the IFIs [international financial institutions] should have done more, especially in the context of the economies in transition to develop an appropriate framework of property rights in support of markets. . . . [I]n considering the future of the two institutions, their activities need to be geared to strengthening the private sector and the appropriate role of government in relation to it.”

—Anne O. Krueger (1998, 2003)

“I do not accept the view that when it comes to our poorer member countries, we should not be lending to them, but should turn it over to someone else. . . . Is the poverty reduction and growth facility . . . which we are working on jointly with the World Bank . . . going to be an improvement in the way we deal with countries? Absolutely. Why? Because . . . it forces us, in cooperation with the World Bank, to make sure that the macroeconomic framework is consistent with what needs to be done for social reasons. Macroeconomic instability is bad for everyone everywhere. . . . That is why we should remain in these countries. . . . But we cannot do that in a way that ignores the fact that poverty is the main problem confronting these countries, and that there must be massive efforts, spearheaded by the World Bank, to reduce poverty in these countries.”

—Stanley Fischer, IMF first deputy managing director (2000b)

“A changed IMF is needed for the changed world we now have. . . . As we look to the future we need to redouble our efforts to find better approaches if not answers to fundamental questions. . . . How do we balance concerns about intrusiveness in national affairs and a desire to promote national ownership of reform programs with a desire to see governments take bolder steps to, for example, build stronger social safety nets, implement core labor standards, em-

power civil society groups, reduce the role of government in the economy, and address critical issues related to governance, corruption, and crony capitalism?”
—U.S. Treasury Secretary Summers (1999)

“[T]he proposed eligibility criteria [for IMF lending in the Meltzer Report] are too narrow. Even where they are met, they would be unlikely to protect economies from the broad range of potential causes of crises. The criteria focus on the financial sector, and yet even problems that surface in the financial sector often have their roots in deeper economic and structural weaknesses. One simply cannot predict with confidence what the next generation of crises will be and therefore we need to preserve the IMF’s ability to respond flexibly to changing circumstances.”

—U.S. Treasury *Response to the Meltzer Report* (2000b, 17)

“A central part of the programs in the Asian crisis countries was an unprecedented body of structural reforms. . . . The overriding question is whether it was appropriate to place so much emphasis on structural reform measures in the financial and corporate sectors. . . . The answer is clearly yes.”

—*IMF Report* (Lane et al. 1999) on Fund Programs in Indonesia, Korea, and Thailand

“[T]he bottom line of the ‘era of the IFIs,’ despite obvious shortcomings, has been an unambiguous success of historic proportions in both economic and social terms.”

—*Minority Dissent, Meltzer Report* (Bergsten et al. 2000, 111)

As suggested above, an active debate has long been under way—and has intensified in the wake of the Asian crisis—about the appropriate scope and intrusiveness of IMF policy conditionality. In this paper, I take up one key element of that debate, namely, the role of structural policies in IMF-supported adjustment programs. By “structural policies,” I mean policies aimed not at the management of aggregate demand but rather at either improving the efficiency of resource use or increasing the economy’s productive capacity. Structural policies are usually aimed at reducing or dismantling government-imposed distortions or putting in place various institutional features of a modern market economy. Such structural policies include, inter alia, financial-sector policies; liberalization of trade, capital markets, and the exchange rate system; privatization and public enterprise policies; tax and expenditure policies (apart from the overall fiscal stance); labor-market policies; pricing and marketing policies; transparency and disclosure policies; poverty reduction and social safety-net policies; pension policies; corporate governance policies (including anticorruption measures); and environmental policies.

To set the stage for what follows, it is worth summarizing the main concerns and criticisms that have been expressed about the IMF’s existing ap-

proach to structural policy conditionality.³ These typically take one or more of the following forms.

First, there is a worry that wide-ranging and micromanaged structural policy recommendations will be viewed by developing-country borrowers as so costly and intrusive as to discourage unduly the demand for Fund assistance during crises (see, e.g., Feldstein 1998). Even though the cost of borrowing from the Fund (the so-called rate of charge) is much lower than the cost of borrowing from private creditors—particularly during times of stress—we observe that developing countries usually come to the IMF “late in the day” when their balance-of-payments problems are already severe.⁴ This suggests that developing countries place a nontrivial shadow price on the policy conditions associated with Fund borrowing. The concern is that if these conditions become too onerous, emerging economies will wait even longer to come to the Fund (as Thailand did in 1997) or will turn to regional official crisis lenders that offer easier policy conditionality (e.g., in 1998 Malaysia was one of the first beneficiaries of low-conditionality Miyazawa Initiative funds, and Asian countries could eventually decide to elevate the infant Chiang-Mai swap arrangements into a full-fledged Asian Monetary Fund).⁵ The outcome—so the argument goes—would then be even more difficult initial crisis conditions, greater resort to the antisocial behavior that the Fund was established to prevent, and a tendency toward Gresham’s Law of conditionality (according to which weak regional conditionality would drive out not only the unnecessary but also the necessary elements of Fund conditionality).

A second concern is that insistence on deep structural reforms in cases of illiquidity (rather than insolvency) will serve only to frighten private investors about the size of the problem, thereby rendering more difficult the restoration of confidence and the rollover of short-term capital flows that are the keys to resolving the liquidity crisis (see Radelet and Sachs 1998). No country (including the Group of Seven [G7] countries) is without some structural weaknesses, but it is argued that, however desirable structural policy reforms may be for the performance of the economy over the longer term, it is a mistake to suggest that such reforms are indispensable to resolving the crisis (when they are not). Among the Asian crisis countries, Korea is identified as a case in which solvency was never in question and less

3. Neither these concerns and criticisms, nor the counterarguments outlined later in this section, should be interpreted as my own views. I provide my own summary assessment of past fund structural conditionality in section 5.1.4.

4. The Fund’s rate of charge averaged a little over 4 percent from 1997 through the first half of 2000; in contrast, emerging market bond spreads (relative to U.S. Treasuries) have fluctuated from 375 to 1,700 basis points since the outbreak of the Thai crisis in mid-1997.

5. See C. Fred Bergsten’s “Towards a Tripartite World” (*The Economist*, 15 July 2000, 23–26) on regional financial initiatives in Asia.

emphasis on structural reform both in the diagnosis and the policy prescription would have produced a milder crisis.

Concern number three is with equal treatment of countries—one of the Fund's key operating principles. Here, the argument is that the Fund has been asking for sweeping structural reforms from developing countries that it would not ask of industrial countries were the latter in similar circumstances. As Paul Volcker put it, "When the Fund consults with a poor and weak country, the country gets in line. When it consults with a big and strong country, the Fund gets in line" (Volcker and Gyohten 1992). Although differences across countries in economic and political power are a fact of life, the argument is that requiring developing countries to undertake more structural remedies than would their industrial-country counterparts undermines local "ownership" of Fund programs. It also works at cross purposes from simultaneous efforts to forge a consensus on strengthening the international financial architecture in (mixed developing-country and industrial-country) groups like the Group of Twenty (G20) and the Financial Stability Forum (FSF).

Yet a fourth criticism is that permitting the Fund to stray from its core competence of macroeconomic and exchange rate policies into a host of structural policy areas results in poor crisis management, weakens the Fund's overall reputation for competent analysis and advice (with adverse spillovers for the credibility of its recommendations in core policy areas), and runs counter to a sensible division of labor and an application of comparative advantage among the various international financial institutions (IFIs). In this connection, critics have maintained that the Fund bungled bank closures in Indonesia and precipitated a credit crunch in the crisis countries by requiring an unduly rapid increase in bank capitalization (see, e.g., Stiglitz 1999); that the Fund lacks both the expertise and staff resources to make timely and sound policy recommendations in areas as diverse as corporate governance, trade policy, privatization, poverty reduction, and environmental management; and that "mission creep" on the part of both the Fund and the World Bank, in addition to a blurring of responsibilities between them, reduces the public and legislative support necessary to fund them adequately (see Council on Foreign Relations Task Force 1999). Long-term structural reforms (at least outside the financial sector) and poverty reduction should be the main business of the World Bank—not of the IMF.

A fifth charge is that the way the Fund has been managing its structural policy conditionality is flawed. Specifically, the argument is that multiplication of structural performance conditions, the specification of "micro" policy measures, and the increasing reliance on (qualitative) structural benchmarks and program reviews (as monitors of policy performance) have combined both to increase the uncertainty facing Fund borrowers and to lower the incentive to follow through with structural reform. Performance criteria were instituted not only to assure the Fund that its financial re-

sources were being used for the purposes intended but also to assure the borrowing country that if it undertook certain prespecified policy actions it would be eligible to draw (see Guitian 1981; Polak 1991). Also, because performance criteria were relatively few in number, easily measured, and macro in their impact, they both conveyed a relatively clear message about which policy actions were deemed (by the Fund) to carry the highest priority and provided a fairly predictable link with bottom-line economic outcomes (e.g., improvement in the balance of payments). However, when a Fund program contains, say, on the order of fifty or more qualitative structural policy conditions, when many of these conditions are very micro in nature, and when both fulfillment of these conditions and eligibility to draw require judgmental calls by the Fund, signals, impacts, and incentives will be more muddled. Should meeting thirty of fifty structural policy conditions be interpreted as a “good overall effort” that merits Fund support, or should it be viewed as a significant noncompliance with the program?

Suffice to say that these criticisms of the Fund’s structural policy conditionality have not gone unchallenged. Again, in the spirit of motivating the subsequent discussion, it is well to consider the following counterarguments.

Although the structural policy conditions the IMF attaches to its loans are often demanding and threaten vested interests within the country, emerging economies recognize that a Fund program represents their best chance to make real traction on the structural weaknesses that have underpinned their crisis vulnerability. Private capital markets, although they sometimes supply strong disciplining force, are not perfect substitutes for either the Fund’s specific policy advice or its financing; indeed, in more than a few cases, private creditors will not extend credit in large amounts until the Fund has blessed a country’s policies.⁶ Turning the steering wheel over temporarily to an outside party is always costly, but better the Fund than one or two large G7 countries. Ironically, the structural policy measures that have drawn the most critical fire in several of the Asian crisis countries (Indonesia and Korea) were for a long time high on the priority list of domestic reformers, but they could not get those reforms implemented (over the opposition of the ruling elite) in a noncrisis situation.⁷ At this point,

6. Fischer (2000b, 1) argues that the fundamental reason why one needs an institution like the IMF is that “the international financial system left to itself does not work perfectly, and it is possible to make it work better for the sake of the people who live in that system.” Also, see Masson and Mussa (1995) and Krueger (1998). Rodrik (1995) notes that an experiment in which private creditors attempted to specify and monitor conditionality in Peru was soon discontinued.

7. See Haggard (2000). On the role of domestic reformers in the Asian crisis countries, he concludes as follows: “it is misguided to see the course of policy solely as a response to external political pressures from the international financial institutions and the United States. . . . At least in some important policy areas, domestic groups were reaching surprisingly similar conclusions on the need for reform” (12).

there is no plan to turn Asian swap or credit arrangements into a serious rival to the Fund with competing policy conditionality. Also, very few crisis countries (in Asia or elsewhere) have seen capital controls as the preferred mode of crisis management. Just as it is not optimal for a host country to establish the weakest regulatory and prudential regime simply because it gives market participants the most freedom of action, it is not optimal (from the viewpoint of developing countries) to make Fund structural policy conditionality too easy or flexible. Fund *gaiatsu*—warts and all—may still be the best option out there for jump-starting structural reform.

The distinction between illiquidity and insolvency is not regarded as particularly helpful in most crisis situations, because the dividing line between the two often rests on the quality of crisis management, and because countries differ from firms both in the nature of the relevant collateral and in their willingness (as opposed to ability) to pay (see Fischer 1999). Although investor panic was an important part of the Asian crisis story, so too were “bad fundamentals” that increased downside risk. For example, in the run-up to the Korean crisis, seven of the thirty largest *chaebol* were essentially bankrupt; there were large terms-of-trade losses in 1996 (especially for semiconductors); nonperforming loans in the banking system and leverage in the corporate sector were already high; there was a low return on invested capital; capital inflows were biased toward short-term capital and against foreign direct investment; there was a lack of transparency (including on the country’s short-term foreign liabilities); and substantial political uncertainty exacerbated the government’s credibility problem.⁸ Yes, many of these structural problems were of long standing, and despite them Korea had shown impressive growth performance over several decades. And yes, Korea has staged an impressive V-shaped recovery without eliminating all these structural problems. Nevertheless, it does not follow that Korea could have regained market confidence without making a good “start” on structural reform in 1997–98. Fund financing–cum–debt rescheduling and an (eventual) turn to easier monetary and fiscal policies—without any structural policy reform—would not have turned the situation around. Treating only the symptoms and not the (structural) root of the problem is not the way to restore confidence. Looking at precrisis fiscal positions in the crisis countries without considering the contingent government liabilities associated with financial-sector restructuring provides a misleading picture of fundamentals (see Boorman et al. 2000). Moreover, the alleged negative effect of Fund public pronouncements on market confidence is said to be much exaggerated. Once Thailand’s fall “woke up” market participants to the poor health of banks and corporates in the rest of Asia and every large

8. See Roubini’s comments in McHale (2000b). Claessens et al. (1999) also found that (pre-crisis) the four countries most seriously affected by the Asian crisis ranked low on the quality of the regulatory environment in an international comparison of middle-income emerging economies in East Asia and Latin America.

Group of Ten (G10) bank and security house in the region was issuing weekly reports on the rising share of nonperforming loans in Asian financial systems, it is very unlikely that a Fund statement claiming it was only a short-term liquidity crisis would have turned the tide (after all, the IMF's then managing director was already telling all who would listen that the crisis was really "a blessing in disguise").⁹

Reflecting, *inter alia*, their less preferred access (in terms of maturity, currency, and predictability) to international capital markets, their weaker institutional framework (ranging from judicial systems to insolvency regimes), and their track record of higher political instability, developing countries *are* different from industrial countries. Recognizing this difference is not dispensing unequal treatment but seeing the world as it is. If the Asian crisis countries—despite their impressive performance on economic growth, inflation, and macro fundamentals over a long period—were regarded by private financial markets as being just like industrial countries, they could have "done an Australia" and got out of the crisis by lowering interest rates and letting their exchange rates depreciate moderately—and this without any Fund assistance.¹⁰ In the event, they could not do that. Nor will the crisis countries be able to sustain their recoveries if they lapse back into the same structural weaknesses they had before. Consequently, it is not realistic to expect a developing country that gets into a crisis to live by the same structural policy conditionality as would a troubled industrial country.¹¹ For the foreseeable future, developing countries will have to contend with a history of banking, debt, and currency crises, and restoration of confidence will often require a different dose and mix of macroeconomic and structural policies than would be the case for industrial countries. There is no indication that disagreement over past Fund structural policy conditionality is hampering the work of groups like the G20 and the FSF; on the contrary, those groups are making real progress in areas like the application of international financial standards.

The IMF has developed considerable expertise in dealing with banking and financial-sector problems in developing countries. Over the past five years, more than forty-five specialists (including former bank supervisors) have been added to the staff of the Fund's Monetary and Exchange Affairs Department alone. Admittedly, bank closures in Indonesia did not go well. However, since deposit insurance arrangements were not in place, since the authorities were willing to close only a small share of the insolvent banks, and since there were concerns about the moral hazard effects of a blanket

9. See Goldstein (1998) and Ahluwalia (2000) on the "wake up" hypothesis as an explanation of the contagion in the Asian crisis.

10. See Krugman (1998) on what the "confidence game" means for monetary and fiscal policies in developing countries during a crisis versus what is asked from industrial countries.

11. See Eichengreen and Hausmann (1999) on financing differences between developing countries and industrial countries.

guarantee, there was no easy alternative to that action (see Lindgren et al. 1999). Likewise, if stricter bank capitalization requirements had not been instituted in the crisis countries, we would have seen rampant “double-or-nothing” lending behavior by insolvent lenders and an even higher fiscal bill for the bank cleanup. Evidence on the existence of a credit crunch in the crisis countries in 1997–98 is far from clear-cut (see Lane et al. 1999).

In areas outside the Fund’s comparative advantage, the Fund draws heavily on other IFIs with the requisite expertise—and especially on the World Bank. This collaboration is particularly close on poverty reduction and social safety net issues but also applies increasingly to corporate governance, privatization, trade policy, and environmental impacts. Eliminating all overlap between the IMF and the World Bank (on fiscal and banking reform) is neither feasible nor desirable. The Fund’s major focus in the poor countries remains on the macroeconomic framework—a specialization that no other IFI is as qualified to handle. A merger of the Fund and the World Bank is unappealing, both because it would sacrifice the speed and efficiency that come with a still rather small IMF and because a mega-IFI would have too much power across a wide spectrum of macro and micro-economic issues.

Yes, the Fund has given increased emphasis in recent years to economic growth and to social conditions in the design and implementation of its programs with developing countries, just as it was responsive to the unique opportunity and massive need for institution-building systems in the fledgling market economies and new democracies of Eastern Europe. The world has changed. If the Fund did not change with it, and if the Fund did not embrace the same objectives in its programs as its members pursue in their national economic policies, there would be little chance that IMF programs would be either agreed upon or implemented (see Camdessus 1999b).

Structural policies are not like macroeconomic policies, and indicators of policy compliance have to reflect those differences. Progress on banking supervision or privatization cannot be measured in the same way net domestic credit or international reserves are tracked. Performance benchmarks for structural policies have to be qualitative, and a measure of discretion is needed to evaluate the results. Also, because of the interdependencies among structural policies, a macroeconomic impact will come only if progress is made on many fronts simultaneously. Furthermore, the devil is in the details. It makes a big difference if the borrowing country responds to a Fund condition for a large cut in the budget deficit by slashing expenditure on health and education versus the curtailment of the national car project. Moreover, because both the implementation of and payoff from structural projects take longer than macroeconomic and exchange rate policies, it is necessary to measure progress along the way. All of this produces many detailed structural performance tests and some uncertainty about whether the

overall effort will warrant Fund financial support, but there are no short-cuts that would work better.

The rest of the paper elaborates on these issues and sets out some additional arguments and factual material relevant for gauging what IMF structural policy conditionality should be like in the future. In section 5.1.2, I ask what, if any, guidance on structural policy involvement can be gleaned from the Fund's charter and guidance notes from its executive board. I then discuss three alternative mandates for Fund lending within which structural policy conditionality might operate—ranging from a narrow one based on correction of balance-of-payments problems and resolution of the current crisis, to broader ones that add avoidance of future crises and pursuit of “high-quality” economic growth to the agenda. Section 5.1.3 looks at various dimensions of Fund structural policy involvement and conditionality—both in the Asian crisis countries over the past three years and more broadly over the past several decades. It also offers some tentative conclusions on the effectiveness of that conditionality, with particular emphasis on the compliance with Fund conditionality. Because very little factual material has been published heretofore on fund structural policy conditionality, this section contains a number of tables and charts documenting the patterns in such conditionality. In section 5.1.4, I speculate on why the scope and micromanagement of Fund structural policy conditionality have increased in recent years. Section 5.1.5 lays out a set of potential approaches to streamlining Fund structural policy conditionality if, as seems increasingly likely, the international community and IMF management were to agree that such streamlining would be desirable. Finally, section 5.1.6 provides some brief concluding remarks that summarize my own views on Fund structural policy conditionality.

5.1.2 Structural Policies and the Mandate of the International Monetary Fund

Scripture and Field Manuals

One starting point for figuring out how involved the IMF should be in structural policies would be to look at the Fund's basic marching orders. These range from the IMF's charter (called the “Articles of Agreement”) to specific guidance notes issued by the Fund's executive board to IMF staff.

List A reproduces (from Article I of the Articles of Agreement) the Fund's purposes. Although amendments have been made to other parts of the charter over the past fifty-five years, this is not so with the purposes. Two things are immediately obvious from even a casual reading. There are many purposes, not just one; and there are a number of terms and concepts—such as “confidence,” “national and international prosperity,” “temporary,”

and “exchange system”—that are (and indeed, have been) susceptible to multiple interpretations.

List A

Purposes of the IMF

1. To promote international monetary cooperation through a permanent institution that provides the machinery for consultation and collaboration on international monetary problems.

2. To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.

3. To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.

4. To assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade.

5. To give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity.

6. In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balance of payments of members.

The Fund shall be guided in all its policies and decisions by the purposes set forth in this article.

It is clear (at least to me) that a primary objective is not only to correct balance-of-payments disequilibria but also to do so in a particular way, that is, in a way that doesn't involve either excessive deflation or unemployment at home or beggar-thy-neighbor policies. This is how I interpret the phrases (in paragraph 5) “without resorting to measures destructive of national and international prosperity” and (in paragraph 3) “to avoid competitive exchange depreciation.” Such an interpretation is of course also consistent with the Fund's establishment as a response to the beggar-thy-neighbor and Great Depression problems of the 1920s and 1930s.

There is also clear support for measures that promote openness to international trade and a multilateral system of payments, and opposition to measures that hamper this openness. Capital movements are not men-

tioned. Again, this is consistent with the perceived (trade-output vicious circle) lessons of the 1920s and 1930s and with the then popular view about the perils of destabilizing capital flows.

Although there is no denying that a key task of the IMF at the time of its creation was to oversee a system of fixed but adjustable exchange rates, I interpret the promotion of “exchange stability” (in paragraph 3) as going beyond any particular form of exchange arrangements (be it adjustable pegs, currency boards, floating rates, etc.). Put another way, I don’t see the *raison d’être* of the Fund as having disappeared in the early 1970s along with the arrival of floating exchange rates. If the intention were otherwise, paragraph 3 would presumably have referred to “exchange rate” stability, and there be would no purposes other than that one.

Although Article I makes it plain that the framers regarded “high levels of employment and income” and “development of productive resources” as good things, it doesn’t say that the Fund should pursue those objectives by whatever means available. Instead, they specify that the Fund should facilitate “the expansion and balanced growth of international trade” and “contribute *thereby*” to buoyant domestic economic activity.

Where else might one look in the Fund’s charter for advice relevant to structural policy conditionality? Many would say the revised (in 1976) Article IV, which deals with general obligations of member countries and with the Fund’s surveillance responsibilities. Here, economic growth and, to a lesser extent, international capital movements, get greater play than in the Fund’s purposes. Specifically, the new Article IV recognizes specifically that the essential purpose of the international monetary system is to provide a framework that both “facilitates the exchange of goods, services, and *capital* among countries, and that sustains sound economic growth.” More noteworthy, member countries assume the general obligation to “endeavor to direct . . . economic and financial policies toward the objective of fostering orderly economic *growth* with reasonable price stability,” and the fund assumes the obligation to oversee the “compliance” of each member country with this obligation.

Since “economic and financial policies” directed toward orderly economic growth potentially covers a lot of ground, the practical upshot of the revised Article IV was that it gave the Fund a much broader license to conduct wide-ranging surveillance and annual consultations with members. Ever since then, the Fund’s Article IV consultation reports have covered a host of policy areas, including many that would be designated as structural policies.¹² Even though Article IV carries the title “Obligations Regarding Exchange Arrangements,” it embodied the view that you had to look at the

12. For a review and analysis of the content of Fund surveillance, see Crow, Arriazu, and Thygesen (1999).

underlying domestic policy determinants of a stable exchange rate system to see if countries were meeting their international obligations.¹³ Yes, Article IV is about Fund surveillance, not about Fund policy conditionality. However, the fact that the former has been given much wider scope (since at least the mid-1970s) probably has contributed somewhat to a wider field of view in Fund lending arrangements as well (more on that in section 5.1.4).

But what about more specific directives relating to performance criteria agreed and issued by the Fund's executive board? In my view, the most relevant document is probably the conditionality guidelines for standby arrangements, issued in 1979; see list B. To make a long story short, although the guidelines permit the number and content of performance criteria to vary with a country's problems and institutional arrangements, guideline 9 specifies, *inter alia*, that performance criteria will "normally be confined to macroeconomic variables" and that "performance criteria may relate to other variables *only in exceptional cases when they are essential for the effectiveness of the member's program because of their macroeconomic impact*" (italics mine). My interpretation of all this is that, at least in Fund standby arrangements, the intention was to limit the number of structural-policy performance criteria and to avoid "micro" conditionality (that is, measures that don't have macroeconomic impact). Although these guidelines have been revisited many times during later board reviews of conditionality, they have been repeatedly endorsed.

List B

Conditionality Guidelines for Fund Standby Lending

1. Members should be encouraged to adopt corrective measures, which could be supported by use of the Fund's general resources in accordance with the Fund's policies, at an early stage of their balance-of-payments difficulties. The article IV consultations are among the occasions on which the Fund would be able to discuss with members adjustment programs, including corrective measures, that would enable the Fund to approve a stand-by arrangement.

2. The normal period for a stand-by arrangement will be one year. If, however, a longer period is requested by a member and considered necessary by the Fund to enable the member to implement its adjustment program successfully, the stand-by arrangement may extend beyond the period of one year. This period in appropriate cases may extend up to but not beyond three years.

13. Eichengreen (1999) has made a similar argument that the Fund cannot expect to be successful at promoting international financial stability without addressing sources of financial instability at the national level.

3. Stand-by arrangements are not international agreements and therefore language having a contractual connotation will be avoided in stand-by arrangements and letters of intent.

4. In helping members to devise adjustment programs, the Fund will pay due regard to domestic social and political objectives, the economic priorities, and the circumstances of members, including the causes of their balance-of-payments problems.

5. Appropriate consultation clauses will be incorporated in all stand-by arrangements. Such clauses will include provision for consultation from time to time during the whole period in which the member has outstanding purchases in the upper limit tranches. This provision will apply to whether the outstanding purchases were made under a stand-by arrangement or in other transactions in the upper credit tranches.

6. Phasing and performance clauses will be omitted in stand-by arrangements that do not go beyond the first credit tranche. They will be included in all other stand-by arrangements but these clauses will be applicable only to purchases beyond the first credit tranche.

7. The managing director will recommend that the executive board approve a member's request for the use of the Fund's general resources in the credit tranches when it is his or her judgment that the program is consistent with the Fund's provisions and policies and that it will be carried out. A member may be expected to adopt some corrective measures before a stand-by arrangement is approved by the Fund, but only if necessary to enable the member to adopt and carry out a program consistent with the Fund's provisions and policies. In these cases the managing director will keep executive directors informed in an appropriate manner of the progress of discussions with the member.

8. The managing director will ensure adequate coordination in the application of policies relating to the use of the Fund's general resources with a view to maintaining the nondiscriminatory treatment of members.

9. The number and content of performance criteria may vary because of the diversity of problems and institutional arrangements of members. Performance criteria will be limited to those that are necessary to evaluate implementation of the program with a view to ensuring that the achievement of its objectives. Performance criteria will normally be confined to (a) macroeconomic variables and (b) those necessary to implement specific provisions of the articles or policies adopted under them. Performance criteria may relate to other variables only in exceptional cases when they are essential for the effectiveness of the member's program because of their macroeconomic impact.

10. In programs extending beyond one year, or in circumstances in which a member is unable to establish in advance one or more performance criteria for all or part of the program period, provision will be made for a review in order to reach the necessary understandings with the member for

the remaining period. In addition, in those exceptional cases in which an essential feature of the program cannot be formulated as a performance criterion at the beginning of a program year because of substantial uncertainties concerning major economic trends, provision will be made for a review by the Fund to evaluate the current macroeconomic policies of the member, and to reach new understandings if necessary. In these exceptional cases the managing director will inform executive directors in an appropriate manner of the subject matter of a review.

11. The staff will prepare an analysis and assessment of the performance under programs supported by use of the Fund's general resources in the credit tranches in connection with article IV consultations and as appropriate in connection with further requests for use of the Fund's resources.

12. The staff will from time to time prepare, for review by the executive board, studies of programs supported by stand-by arrangements in order to evaluate and compare the appropriateness of the programs, the effectiveness of the policy instruments, and the observance of the programs, and the results achieved. Such reviews will enable the executive board to determine when it may be appropriate to have the next comprehensive review of conditionality.

However, one must also take note that a variety of other lending arrangements (besides standbys) has been created in the Fund with the support of the membership over the past thirty years (ranging from a facility to assist transition economies in coping with the shift away from state trading to multilateral market-based trading, to one that was to assist countries experiencing liquidity problems related to Y2K). More to the point of this paper, some of those lending windows are directly aimed at protracted balance-of-payments problems and at supporting comprehensive efforts at macroeconomic *and* structural reform. These include the Extended Fund Facility (EFF; established in 1974), and both the Structural Adjustment Facility (SAF; established in 1986) and Enhanced Structural Adjustment Facility (ESAF; established in 1987); eligibility for both the SAF and the ESAF is restricted to low-income countries.¹⁴ For these lending windows, structural policy involvement is at the heart of the exercise, and there is little guidance on how many or what kinds of structural policy measures would be viewed as "out of bounds."

Given the prominence of governance issues in the Asian crisis, a final guidance note worth noting is the one issued in July 1997 by the Fund's executive board on "The Role of the IMF in Governance Issues." Although the note states right at the beginning that "the responsibility for governance issues lies first and foremost with the national authorities," it seems to give

14. In 1999, the ESAF was reorganized into the Poverty Reduction and Growth Facility (PRGF).

the Fund staff quite a wide berth to include governance and corruption measures in Fund conditionality if they can make the case that governance problems have some direct macroeconomic impact. In addition, although the note urges the Fund staff to rely on other institutions' expertise in areas of their purview, it states that the Fund could nevertheless recommend conditionality in those areas (outside the Fund's expertise) if the staff considered that such measures were "critical to the successful implementation of the program." Given the timing and context of this guidance note (just at the outset of the Asian crisis), some IMF staff have expressed the view (to me) that the Fund's board was sending them a signal that they would henceforth not support programs that ignored serious and widespread governance and corruption problems.

To sum up, the Fund's existing marching orders on structural policy conditionality are Janus-faced enough that both supporters of narrow conditionality and those of more comprehensive conditionality can find their own biblical passages to buttress their arguments. On the one side, I don't see in the Fund's charter a broad agenda aimed at high-quality growth. What I see instead is a focus on balance-of-payments adjustment, trade opening, elimination of payments restrictions, efforts to increase the stability of the exchange rate system, and a directive to avoid modes of external adjustment that make recession or deflation deeper than necessary and that impose undue costs on other countries.¹⁵ This is not to deny that the Fund's membership may want to pursue high-quality growth (and poverty reduction) for a variety of reasons, including moral imperatives. It's just that I can't find that commandment on the original stone tablets. In a similar vein, the Fund's conditionality guidelines for standby arrangements appear to have had the intention of limiting the number of structural performance criteria, particularly if they are micro in nature. On the other side of the ledger, the Fund's overall surveillance responsibilities (under the revised Article IV) are quite wide-ranging: as regards structural policies, a succession of specific lending windows has been established over the past twenty-five years or so with an explicit structural policy orientation, and guidance notes on "new" structural policy issues like governance and corruption give the Fund staff considerable leeway to include such measures in conditionality as long as they can make a case that they are critical to the success of the program. Perhaps more telling, I could find no evidence of concern about the scope or intrusiveness of structural policy conditionality in the published summaries (so-called Public Information Notices, or PINs) of executive board meetings on the Thai, Indonesian, and Korean

15. It's also relevant to note that, unlike the charter of the EBRD, the Fund's charter says nothing about promoting "democracy"; see Polak (1991) for a discussion of political influences on IMF lending.

programs over the past three years—even though the number and detail of structural conditions in those three programs are extraordinary (see section 5.1.3 below).

Three Alternative Mandates

If there is relatively little guidance available about the appropriate intrusiveness of Fund structural policy conditionality from official sources, one might consider what different mandates for the Fund would imply about such conditionality. Here, I consider three possibilities, starting with the narrowest and ending with the broadest (and most ambitious).

Mandate I

The Fund's primary focus would be on macroeconomic and financial stability; its crisis management guideline would be to assist a country to get out of the current crisis as soon as possible (without imposing undue costs on itself or its neighbors).

An announced IMF focus on macroeconomic and financial stability would be similar to the increasing popular practice of national central banks to announce that their primary objective is price stability. It doesn't preclude giving some consideration to other objectives, but it makes clear which objective is king and where the authority's central responsibility lies. The emphasis on getting out of the current crisis would mean that crisis management and resolution—and not crisis prevention—should guide program design. Crisis prevention measures would presumably then be handled by the country on its own *after* the current crisis is resolved.

Would Mandate I preclude Fund structural policy conditionality during a crisis? The answer, I believe, is no. However, the extent of the structural conditions would be limited to measures directly related to resolution of the *current* crisis, and their form would depend on both the nature of the crisis and the institutional structure in place in the crisis country; in addition, the design of essential structural policy conditions outside the Fund's core competence (monetary, fiscal, exchange rate, and financial-sector policies) would need to be handled by other international financial institutions (IFIs). A few examples should suffice to illustrate the point.

Suppose that key contributory factors to a balance-of-payments crisis were an overvalued exchange rate and overly expansionary monetary and fiscal policies. Also assume that correction of relative prices was being thwarted by widespread indexation agreements in wage contracts. Assume that the alternatives to devaluation as an adjustment tool are a more draconian tightening of monetary or fiscal policy (which would drive the domestic economy into deep recession) and a large hike in tariff and nontariff barriers. In that case, reduction or elimination of those indexation provisions could be regarded as essential to external adjustment (without either

excessive deflation or beggar-thy-neighbor effects), and a labor-market performance test could be part of conditionality.¹⁶

Next, consider a case in which the primary source of the external disequilibrium is a large budget deficit. Assume that the necessary fiscal adjustment needs to be large, that the economy is expected to undergo a serious contraction, that the incumbent government is quite unpopular at home (because there is a long history of cronyism and corruption), and that there is no social safety net to speak of. In that situation, it could be argued that the Fund program needs to contain a few structural measures (e.g., the closing of a government cartel or monopoly) to send a visible signal to the public that some patronage is being taken away from well-connected government cronies and therefore that the program will be even-handed—and this even if the structural measures themselves have no macroeconomic impact and lie outside the Fund's core competence.¹⁷ Here, these structural measures might be defended as necessary to establish confidence. Similarly, the creation of an unemployment insurance scheme or some other form of social safety net could be viewed as necessary to sustain popular support for the fiscal correction effort over the one- or two-year program period.

Next, picture a situation in which a banking crisis is under way and no deposit insurance system is in place. Depositors are withdrawing deposits from a group of weak banks, and the government is supporting the weak banks' ability to meet withdrawals by providing liquidity assistance to those banks. The deposit run is spreading, and the liquidity injections are pumping up the monetary aggregates and driving down the exchange rate. It is also known that substantial funds will soon be needed to recapitalize insolvent banks and to increase capital at solvent but still weak banks. Because its debt burden is already high, the government cannot fund all the bank cleanup costs on its own. It will need help from private creditors abroad. Here, too, one could defend structural conditions relating to bank closures or to deposit insurance reform as being essential for resolving the current crisis; without them, the authorities will not be able to control monetary policy and to halt the free fall of the currency. If the *immediate* aim of raising funds from abroad is being hampered by restrictions on capital inflows or by poor disclosure that prevents foreign creditors from judging the worth of domestic banks, the removal or correction of restrictions or disclosure practices too might be defended as a legitimate element in conditionality.

16. Another example in which labor market policies could be considered essential to overcoming the current crisis is when a banking crisis cannot be overcome without financial-sector and corporate restructuring, and the latter cannot be accomplished without revision of restrictive laws governing employee layoffs.

17. Allen (1993, 18) takes such a view: "Structural policies can also help build and maintain the political consensus that will support macroeconomic stabilization—for example, by combating unproductive and politically unpopular rent-seeking activities."

In contrast to the above scenarios, consider a crisis situation brought on, say, by a large terms-of-trade shock or a shift in investor sentiment stemming from contagion in a neighboring country. Assume also that there are many structural-policy weaknesses and institutional gaps but that these are not serious enough or linked closely enough to monetary, fiscal, and exchange rate policies to prevent the crisis from being resolved with traditional macroeconomic instruments plus some Fund financing. Here, however desirable structural measures may be for longer-term performance, they would not be included as conditions for the program. A plain vanilla Fund program will do the job.

Another relevant question is whether Mandate I would still permit the Fund to make a contribution to poverty reduction in poor countries. The answer is yes, but only insofar as macroeconomic and financial stability itself contributes to poverty reduction, or because the Fund (in collaboration with the World Bank) sees the incorporation of social safety nets into crisis resolution programs as necessary for the successful implementation of those programs. Longer-term efforts (outside of crises) to fight poverty would then be handled by the World Bank and the regional development banks.

Mandate II

The Fund's primary focus would be (as in Mandate I) on macroeconomic and financial stability: its crisis guideline would be to assist a country not only to get out of the current crisis but also to minimize the chances of getting into another one down the road.

Although the Fund's core competence remains the same in Mandate II as in Mandate I, the big difference is that the fund now incorporates crisis *prevention* as well as crisis resolution in program design. An implicit judgment here is that the country needs to use the crisis as a mechanism to reduce its crisis vulnerability and that it would not be able to do this on its own (i.e., without a Fund program) after the current crisis is resolved. Better, then, to "make hay while the sun shines" and combine crisis resolution and crisis prevention in the current program. If confidence in the crisis economy is very low, the Fund might also argue that investors will not return unless there is evidence that the probability of another (near-term) crisis is low; this in turn requires proof that the old (crisis-prone) system is changing, and structural reform would be part and parcel of such proof.

Mandate II increases substantially the scope for structural policy conditionality, even without going into noncore areas of economic policy. Again, a few examples convey the flavor.

Assume that the country has a long-standing problem of undisciplined monetary policy and that monetary policy excesses are also a key factor in the current crisis. In that case, the Fund might argue that a performance criterion that simply says that monetary policy will be tightened within the existing regime will not be credible. In this situation, the program might con-

tain structural policy conditionality that either specifies granting independence to the central bank or takes the monetary reins out of the central bank's hands by establishing a currency board or single currency.

One could tell a similar story about long-standing weaknesses in fiscal policy that lead a country to accumulate a very heavy external debt burden. When, say, a large negative shock occurs to the terms of trade (e.g., oil prices fall), foreign investors run for the exits and a debt crisis breaks out. Assume that the chronically weak fiscal position owes much to a narrow tax base, to a host of large loss-making public enterprises, and to the absence of proper expenditure-control and budgeting departments in the ministry of finance. In parallel with the immediately preceding example, the Fund might argue that a performance criterion that simply targets a lower fiscal deficit for the next year will not be credible. As such, the Fund program could contain structural conditions for widening the tax base, for privatizing state enterprises, and for establishing new administrative units in the ministry of finance.

Carrying forward the same theme, imagine a banking crisis whose proximate determinants are a sharp contraction of economic activity or a sharp rise in interest rates connected with a defense of a fixed exchange rate. However, assume also that there was a large backlog of nonperforming loans brought on by the following: state-owned banks that lent without any regard to creditworthiness of borrowers; commercial banks that had long demonstrated a proclivity toward "connected lending"; lax loan classification procedures that encouraged the "evergreening" of bad loans and that grossly overstated the true value of bank capital; a legal framework that made it difficult for banks to seize collateral from bankrupt borrowers; ineffective banking supervision from a bank supervisory agency that had neither the political independence nor the mandate or resources to do its job; and lender moral hazard, stoked by repeated episodes of bailing out bank depositors and creditors. Against such a background, the Fund might maintain that a program that merely specified closing insolvent banks and recapitalizing others to international standards would amount to flushing money down the drain. Even if the current banking crisis were resolved, it wouldn't be long before the same underlying vulnerabilities produced a repetition (thereby exacerbating the problem of "prolonged use" of Fund resources). Better then—so the argument would go—to require structural policy conditions that would change each of these poor banking and supervisory practices.

The same kind of argument could be made about the need for conditions (on bank bailouts and the like) to control moral hazard problems, which, by definition, relate to the effect of inappropriately priced insurance arrangements (extended this period) on the risk-taking behavior of policyholders *next period*. Put in other words, it is precisely the worry about avoiding the next crisis that makes it necessary to put additional conditions on the management of the current crisis.

Mandate III

The Fund's focus would be on macroeconomic and financial stability and on sustainable growth; its crisis guideline would be to assist the country not only to get out of the current crisis and to reduce its crisis vulnerability but also to put in place the conditions for sustainable high-quality growth.

The difference here with respect to Mandates I and II is that high-quality growth now occupies a more central role both in the Fund's overall mandate and in its crisis-fighting strategy. Under this more holistic approach, conditionality would likely encompass measures that are viewed as necessary to improve economic growth and protect the poor and the vulnerable, as well as measures to improve the country's resilience to future crises. A hypothetical country scenario can again help to illustrate the differences involved.

Consider a country that is suffering from persistently weak economic growth, a chronic budget deficit, a weak external position, pervasive state intervention, heavy public ownership, protectionism, and a host of governance and corruption problems. A large, negative terms-of-trade shock or a group of bank failures may have pushed this country into crisis, but for the last decade or more it may never have been very far away from crisis.

Reflecting the focus on economic growth (under Mandate III), the Fund and the country authorities might agree that the program ought to have a three-year rather than a one-year tenure, so that any aggregate demand reductions could be made more gradual and so that there would be more time for structural reform to take hold. In addition, the Fund might ask that the country only make good progress toward external payments viability during the program period rather than actually achieving such viability. In an effort to reduce distortions that create an anti-export bias and that hamper efficient resource allocation, the program might well call for the following: scaling back the extent of price controls and state intervention in marketing of exports, foodstuffs, fertilizer, and petroleum products; the reduction or elimination of surrender requirements and controls on foreign exchange allocation; reduced reliance on quantitative restrictions on imports and a reduction in the level and dispersion of tariff rates; privatization of selected public enterprises and the entering into of "performance contracts" with existing managers of public enterprises; liberalization of interest rates (and other measures to move from state to market allocation of credit); development of financial markets for interbank funds, government securities, and stocks; and the phasing-out of government-owned banks.

To protect the most vulnerable groups, such a program would probably also place conditions on the composition of government expenditure cuts, as well as an overall target for the budget deficit. Specifically, these structural conditions could call, *inter alia*, for a shift in government expenditure away from military and "showcase" expenditures toward expenditure on primary education and health care; severance pay and retraining for workers released

from public enterprises that are being privatized; a gradual (rather than abrupt) reduction of price controls on commodities that loom large in poor people's budgets; and the creation of an unemployment insurance system. There might likewise be provisions for special credit arrangements for agricultural producers and for small and medium-sized businesses, and the differential impact of currency devaluation on urban consumers versus agricultural exporters might be subject to partial compensation. As part of efforts to combat corruption problems, audits and public disclosure of findings might be required of certain financial institutions and of government-sponsored monopolies, and employment practices in the civil service could be subject to review. Additionally, core labor standards might be put forward if there were strong evidence of significant departures from them.

To sum up, what gets included in Fund structural policy conditionality depends in good measure on the nature of the crisis and on the extent of interdependence between traditional Fund macroeconomic policy instruments and structural policies. *But the intrusiveness of conditionality also depends on how broad are the objectives of the Fund and the country authorities.* Trying to get out of the current crisis is one thing. Trying to ward off a future crisis is quite another. And trying to spur high-quality growth in a low-income country with a host of government-induced distortions and large institutional gaps is something else again. Yet another relevant factor, particularly as regards the intensity or degree of detail in Fund conditionality, is how much confidence the IMF and creditor governments have in the willingness of the crisis country to carry through on its policy commitments; the greater the skepticism on that score, the greater is likely to be the number of prior actions and other performance tests included in programs. However, that takes us into the next section.

5.1.3 The Structural Content of Fund Policy Conditionality and Its Effectiveness

Thus far, I have summarized arguments about Fund structural policy conditionality and discussed how the Fund's mandate might affect the scope and details of such conditionality. However, I have not discussed the available facts on Fund structural policy conditionality, nor the existing literature on the effectiveness of conditionality. That is the subject of this section. First, I ask how commonplace, wide-ranging, and detailed structural policy conditions have been in Fund programs; whether structural policy conditionality seems to be increasing over time; in what policy areas structural conditionality has been most intensive; and what performance tests have been used to monitor this conditionality. Second, I then ask what we know about the effectiveness of that structural policy conditionality, including the track record on compliance with Fund conditionality. Most of these questions are not entirely straightforward to answer, both because the

relevant data are available only in pieces and because the counterfactual to Fund policy conditionality (that is, what would happen in the absence of a Fund program) is extremely difficult to know or to estimate.

Structural Policies in Fund Programs

Since there is no comprehensive index of Fund structural policy conditionality that is available over a long time period, one has to rely on a set of statistics to tell the story. In what follows, I review, in turn: (a) data on the number of total structural policy conditions per program year for a sample of twenty Stand-By Arrangements (SBAs) and twelve EFFs for the 1996–99 period; (b) data on the average number of structural performance criteria for all Fund programs over the 1993–99 period; (c) data on the number of structural policy conditions (overwhelmingly structural benchmarks) in recent (1997–2000) Fund programs with three Asian crisis countries (Indonesia, South Korea, and Thailand); (d) data on the average number of structural benchmarks per Fund program for thirty-three transition economies over the 1993–99 period; and (e) data on the number of structural benchmarks in earlier SAF programs. For each body of data, I am interested not only in the scope and intensity of structural policy conditionality, but also in the trend, the differences across different types of Fund programs (SBAs, EFFs, and SAF/ESAF/PRGF programs), and the distribution across structural policy areas.

Before getting to all that, a brief digression on the instruments that the Fund uses to monitor compliance with conditionality is warranted. For the purposes of this paper, four of these are of interest.

Performance criteria (PCs) are meant to provide a direct link between program implementation and disbursement of Fund resources. If the criterion is met on the agreed test date (typically set at quarterly intervals), the member country is assured of disbursement; if the criterion is not met, the country cannot draw unless a waiver is obtained. Waivers are granted when a country's noncompliance with performance criteria is viewed by the Fund as inconsequential or when it reflects significant exogenous developments not foreseen at the time the program was framed.¹⁸ PCs are expected to be under the control of the borrower, capable of being precisely and objectively formulated and monitored, and subject to relatively short (usually less than forty-five days) reporting lags. In the structural area, a PC could, for example, specify that elimination of restriction *x* on current payments be accomplished by date *y*, or that three insolvent finance companies be closed by date *z*. *Prior actions* are policy measures that the country agrees to take before a Fund agreement goes into effect. They are apt to be employed when severe imbalances exist and the country is viewed as having had a poor track

18. Waivers also require that the authorities have taken the necessary action to bring the program back on track if this is necessary to meet its objectives.

record of implementation (in earlier Fund programs). *Structural benchmarks* (SBMs) are indicators that aim to delineate the expected path of reform for individual structural policy measures and that can facilitate the evaluation of progress for these actions. Because many structural policies cannot be expressed in quantitative form, structural benchmarks are usually expressed qualitatively; for example, if the program calls for privatization of the state-owned telephone company, submitting the privatization bill to the legislature by date x could be one structural benchmark. Failure to meet structural benchmarks conveys a negative signal but does not automatically render a country ineligible to draw; instead, a decision about eligibility would be judgmental and would likely be taken in a broader mid-year *program review*—itself an instrument of conditionality—with an eye toward the country’s overall progress on the structural front. Program reviews, like SBMs, assess implementation of policies not amenable to monitoring via PCs (because of their imprecise or qualitative nature). Reviews are broader than individual SBMs and can be used, for example, to assess whether there needs to be a change in program design.¹⁹

Number of (Total) Structural Policy Conditions per Program Year

At this point, the most comprehensive measure of Fund structural policy conditionality is that produced by the Fund itself via its so-called MONA database (which stands for Monitoring Fund Arrangements). It is the only series available that combines information on all four types of structural conditions, namely, performance criteria, structural benchmarks, prior actions, and conditions for completion of program reviews. When only one of those structural policy conditions is used, there is a danger that you are seeing only one part of the elephant. The Fund’s index of programmed structural policy measures is then divided by the length of the period to obtain figures on number of programmed structural policy measures per annum. The rub is that this comprehensive measure is so far available only for the twenty SBAs and twelve EFFs over the 1996–99 period. To my knowledge, this comprehensive measure of Fund structural policy conditions has not been published before.

Table 5.1 presents the goods. Three conclusions stand out. First, the number of structural policy conditions that would be typical for, say, a three-year EFF Fund program over the last few years is high; specifically, it would be more than fifty (three times the annual average of eighteen measures per annum).²⁰ For a typical one-year SBA, it would be somewhere be-

19. When conditionality includes a program review, the text of the arrangement specifies what elements are to be reviewed; the review also assesses whether or not the program’s objectives are in jeopardy.

20. Because the data in table 5.1 are expressed as the number of conditions per annum rather than per program, I need to assume that the number of conditions varies proportionally with time to arrive at conclusions about the number in conditions in a “typical” three-year program.

Table 5.1 Number of Programmed Structural Conditions Per Annum, 1996–99

| | SBA _s | EFF |
|--------------------|------------------|-----|
| Median | 9 | 18 |
| Mean | 15 | 18 |
| Standard deviation | 12 | 12 |

tween nine and fifteen (depending on whether we used the median or the mean). This is a far cry from the “only in exceptional cases” guideline called for in the (1979) conditionality guidelines for SBAs. Second, the median number of structural policy conditions is much higher (double) for EFFs than for SBAs. This is not surprising. As noted earlier, EFFs *must* have a structural policy orientation; SBAs may have structural conditionality, too, but don’t necessarily have to (if structural problems are not viewed as serious or pressing). Note that the difference between SBAs and EFFs vanishes when one looks at the mean number of conditions—a finding that could well reflect the presence of a few SBAs with very high structural policy content. Third, there is quite a lot of variation across both SBAs and EFFs in the extent of structural policy conditionality. Because these data are thus far available only for the 1996–99 period as a whole, there is nothing that can be said here about trends.

The Fund has broken down its comprehensive measure of structural policy conditions into ten broad policy areas. The results are portrayed in figure 5.1. In short, what we see there is that about two-thirds of structural policy conditions are concentrated in three areas: financial-sector policies, tax and expenditure reforms, and public enterprises and privatizations. Since the Fund’s core competence is often identified to be monetary, fiscal, exchange rate, and financial-sector policies (see, e.g., Council on Foreign Relations Task Force 1999), this would seem to belie the charge that, on average, most of the Fund’s focus in structural policies is far afield from its main expertise—or, to put it in other words, that Fund structural policy conditionality is typically “a mile wide and an inch thick.” At the same time, figure 5.1 does show that fund structural policy conditionality has reached into a number of “noncore” structural policy areas (e.g., labor markets, social safety nets).

Average Number of Structural Performance Criteria per Program

The Fund’s MONA database also contains information on performance criteria (PCs) for the longer 1993–99 period. Tables 5.2, 5.3, and 5.4 present the average number of performance criteria per program for all Fund programs, for ESAF/PRGF programs, and for SBA and EFF programs, respectively; separate figures are also given for the transition economies and (in table 5.2) for the Asian economies. In these tables, “quantitative perfor-

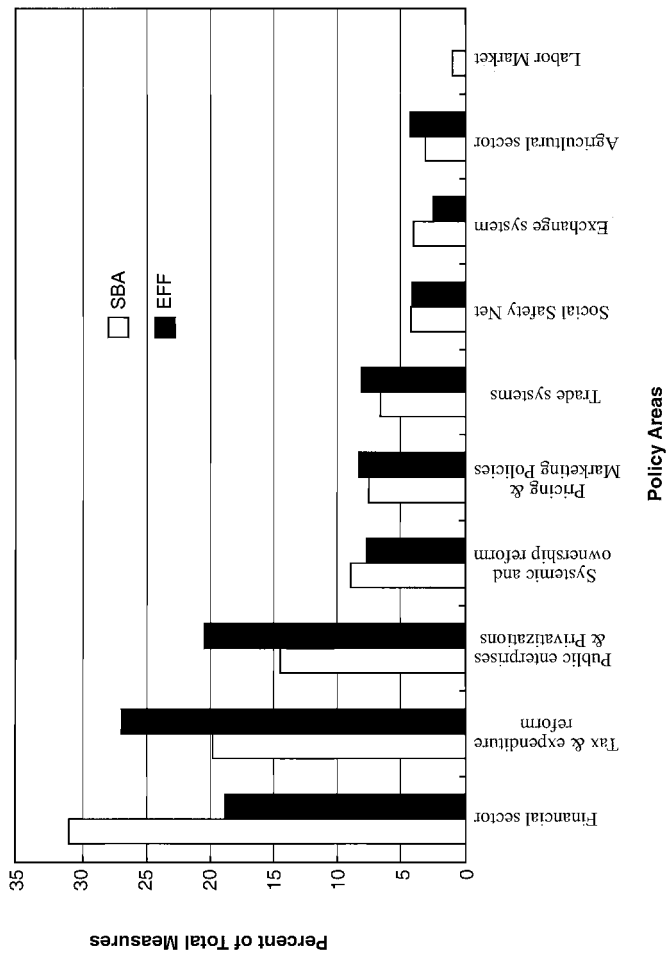


Fig. 5.1 Relative number of IMF structural conditions in different policy areas, 1996-99

Table 5.2 Summary of Performance Criteria in Fund-Supported Programs, 1993–99

| | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 |
|--|------|------|------|------|------|------|------|
| <i>A. Total Number of Arrangements</i> | | | | | | | |
| Number of programs approved | | | | | | | |
| by year | 22 | 35 | 30 | 32 | 21 | 21 | 20 |
| Number of performance criteria | 218 | 373 | 327 | 419 | 328 | 234 | 203 |
| Quantitative | 186 | 276 | 268 | 297 | 191 | 173 | 150 |
| Structural | 32 | 97 | 59 | 122 | 137 | 61 | 53 |
| Number of performance criteria | | | | | | | |
| per program | 10 | 11 | 11 | 13 | 16 | 11 | 10 |
| Quantitative | 8 | 8 | 9 | 9 | 9 | 8 | 8 |
| Structural | 1 | 3 | 2 | 4 | 7 | 3 | 3 |
| <i>B. Transition Economies</i> | | | | | | | |
| Number of programs approved | | | | | | | |
| by year | 9 | 8 | 12 | 12 | 7 | 6 | 4 |
| Number of performance criteria | 82 | 79 | 100 | 156 | 73 | 90 | 37 |
| Quantitative | 78 | 67 | 100 | 125 | 67 | 64 | 37 |
| Structural | 4 | 12 | 0 | 31 | 6 | 26 | 0 |
| Number of performance criteria | | | | | | | |
| per program | 9 | 10 | 8 | 13 | 10 | 15 | 9 |
| Quantitative | 9 | 8 | 8 | 10 | 10 | 11 | 9 |
| Structural | 0.4 | 2 | 0 | 3 | 1 | 4 | 0 |
| <i>C. Asian Economies</i> | | | | | | | |
| Number of programs approved | | | | | | | |
| by year | 0 | 0 | 0 | 0 | 3 | 1 | 0 |
| Number of performance criteria | 0 | 0 | 0 | 0 | 59 | 9 | 0 |
| Quantitative | 0 | 0 | 0 | 0 | 18 | 5 | 0 |
| Structural | 0 | 0 | 0 | 0 | 41 | 4 | 0 |
| Number of performance criteria | | | | | | | |
| per program | | | | | 20 | 9 | |
| Quantitative | | | | | 6 | 5 | |
| Structural | | | | | 14 | 4 | |

Notes: Stand-by, extended facility, and SAF/ESAF/PRGF arrangements. Number of performance criteria refers to all performance criteria over the duration of the program. Performance criteria are classified by year of program approval, irrespective of test dates they applied to. Quantitative performance criteria applying to the same variable are counted only once, even if observance was required for more than one test date.

mance criteria” refers to macroeconomic variables (e.g., the nominal value of the fiscal deficit, net domestic credit of the central bank, the stock of net international reserves, etc.) that are used to track compliance with monetary, fiscal, exchange rate, and external debt policies. “Structural performance” criteria are meant to assess compliance with important structural policy commitments. Note that the data here are calculated per program, not per program year. This is more informative in some respects but also carries the disadvantage that the annual figures can be biased upward

Table 5.3 Summary of Performance Criteria in ESAF/PRGF Arrangements, 1993–99

| | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 |
|--|------|------|------|------|------|------|------|
| <i>A. Total Number of Arrangements</i> | | | | | | | |
| Number of programs approved | | | | | | | |
| by year | 7 | 13 | 7 | 14 | 7 | 11 | 9 |
| Number of performance criteria | 86 | 183 | 116 | 227 | 134 | 132 | 106 |
| Quantitative | 61 | 102 | 81 | 118 | 72 | 97 | 68 |
| Structural | 25 | 81 | 35 | 109 | 62 | 35 | 38 |
| Number of performance criteria | | | | | | | |
| per program | 12 | 14 | 17 | 16 | 19 | 12 | 12 |
| Quantitative | 9 | 8 | 12 | 8 | 10 | 9 | 8 |
| Structural | 4 | 6 | 5 | 8 | 9 | 3 | 4 |
| <i>B. Transition Economies</i> | | | | | | | |
| Number of programs approved | | | | | | | |
| by year | 1 | 1 | 0 | 3 | 1 | 3 | 0 |
| Number of performance criteria | 14 | 14 | — | 60 | 17 | 42 | — |
| Quantitative | 10 | 9 | — | 33 | 13 | 31 | — |
| Structural | 4 | 5 | — | 27 | 4 | 11 | — |
| Number of performance criteria | | | | | | | |
| per program | 14 | 14 | — | 20 | 17 | 14 | — |
| Quantitative | 10 | 9 | — | 11 | 13 | 10 | — |
| Structural | 4.0 | 5 | — | 9 | 4 | 4 | — |

Notes: Number of performance criteria refers to all performance criteria over the duration of the program. Performance criteria are classified by year of program approval, irrespective of test dates they applied to. Quantitative performance criteria applying to the same variable are counted only once, even if observance was required for more than one test date. Dashes indicate no program was assessed for that year.

(downward) if there are more (less) multiyear arrangements agreed in a given year. Note also that because we are dealing only with one component of structural policy conditionality in tables 5.2–5.4, we have to be careful about generalizing about the overall intrusiveness of Fund structural policy conditionality from these figures.

Five main conclusions emerge from tables 5.2–5.6. One is that “structural” PCs are on average less numerous than quantitative macroeconomic PCs—with the notable exception of the three programs for the Asian crisis economies in 1997 (see the upper two panels of table 5.2 versus the lowest one). A second conclusion is that the number of structural PCs in the programs with the three Asian crisis economies in 1997 (an average of 14.0 per program) was far above (roughly four times) both the average for all fund programs over the 1993–99 period (an average of 3.3 per program) and for 1997 alone (an average of 7.0 per program); in contrast, the average number of quantitative macroeconomic PCs was actually lower in the Asian economies than for all Fund programs. Finding number three is that the average number of structural PCs in programs with the transition economies was

Table 5.4 Summary of Performance Criteria in SBA/EFF Arrangements, 1993–99

| | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 |
|--|------|------|------|------|------|------|------|
| <i>A. Total Number of Arrangements</i> | | | | | | | |
| Number of programs approved | | | | | | | |
| by year | 15 | 22 | 23 | 18 | 14 | 10 | 11 |
| Number of performance criteria | 132 | 190 | 211 | 192 | 194 | 102 | 97 |
| Quantitative | 125 | 174 | 187 | 179 | 119 | 76 | 82 |
| Structural | 7 | 16 | 24 | 13 | 75 | 26 | 15 |
| Number of performance criteria | | | | | | | |
| per program | 9 | 9 | 9 | 11 | 14 | 10 | 9 |
| Quantitative | 8 | 8 | 8 | 10 | 9 | 8 | 7 |
| Structural | 0 | 1 | 1 | 1 | 5 | 3 | 1 |
| <i>B. Transition Economies</i> | | | | | | | |
| Number of programs approved | | | | | | | |
| by year | 8 | 7 | 12 | 9 | 6 | 3 | 4 |
| Number of performance criteria | 68 | 65 | 100 | 96 | 56 | 48 | 37 |
| Quantitative | 68 | 58 | 100 | 92 | 54 | 33 | 37 |
| Structural | 0 | 7 | 0 | 4 | 2 | 15 | 0 |
| Number of performance criteria | | | | | | | |
| per program | 9 | 9 | 8 | 11 | 9 | 16 | 9 |
| Quantitative | 9 | 8 | 8 | 10 | 9 | 11 | 9 |
| Structural | 0.0 | 1 | 0 | 0 | 0 | 5 | 0 |

Notes: Number of performance criteria refers to all performance criteria over the duration of the program. Performance criteria are classified by year of program approval, irrespective of test dates they applied to. Quantitative performance criteria applying to the same variable are counted only once, even if observance was required for more than one test date.

below (not above) the average for all Fund programs over this period. Fourth, there have on average been more structural PCs in ESAF/PRGF programs than in SBA and EFF arrangements (taken together).

A fifth finding—at least for all Fund arrangements taken together—is that we do observe some upward trend in the average number of structural PCs as we move from the earlier part of the period (2.0 in 1993–95) to the latter part (3.3 in 1996 and 98–99)—even if we exclude 1997; that being said, the straw that stirs the drink in the average of PC numbers is clearly the high figure (14.0 per program) for the three programs with Asian crisis countries in 1997.

Unfortunately, there are no directly comparable statistics on average number of structural PCs for earlier periods. An unpublished IMF (1987a) study on SBAs and EFFs during the 1979–97 period does show the breakdown of structural PCs by policy area; if I make the (risky) assumption that there was only one PC per policy area indicated for each country, I get an estimate of 1.3 structural PCs per program for that period—about one-third of the average figure (3.3) for 1993–99 (from table 5.2). Polak (1991) reports the average number of total PCs (presumably, quantitative macro-

economic PCs plus structural PCs) per program for some earlier periods. Specifically, his figures are less than 6.0 per arrangement for 1968–77, 7.0 in 1974–84, and 9.5 in 1984–87. The comparable figure taken from table 5.2 for average (total) PCs per program over 1993–99 would be 11.7. If other monitoring components of Fund policy conditionality (prior actions, SBMs, conditions for program reviews) moved in the same direction over this period—and Polak suggests they have—this would point to a significant increase in the monitoring of Fund conditionality over the past thirty years or so.

As regards the distribution of structural PCs across policy areas for earlier periods, the same 1987 IMF study found that the leading categories were the exchange system (12 percent) and the trade system (6 percent). The financial sector, which led the parade in figure 5.1, was in third place in 1979–87, and fiscal policy was yet further behind.

Number of Structural Policy Conditions in Recent Fund Programs with Indonesia, South Korea, and Thailand

Since Fund structural policy conditionality in three Asian crisis countries has had a lot to do with reopening the debate on the appropriate scope and detail of conditionality, it makes sense to give those programs a separate look. In table 5.5, I provide a running count of the number of structural policy conditions—believed to be overwhelmingly made up of conditions for program reviews and structural benchmarks—contained in successive revisions of the Indonesian, Korean, and Thai programs over the 1997–2000 period. In figure 5.2, I present a rough breakdown of the three crisis programs by structural policy areas. In an effort to convey the flavor of the detail in those programs, I have also reproduced in list C the first half of the full SBM matrix for Indonesia as of June 1998. Perhaps it is a hint of one of the main conclusions that it was not practical to attach the full list of structural policy conditions for all three programs: as a group, they are much too long for a paper of this length. The reader should be cautioned that counting the number of structural policy commitments says nothing about which conditions are more important or are more intrusive. Nor does such a count tell us which commitments came at the initiative of the country authorities and which came from the Fund.²¹ Moreover, such a count mixes together what might be called formal conditionality (monitored by specific performance criteria and structural benchmarks) and informal conditionality (monitored by program reviews).

21. Fund staff note that country authorities often use an IMF letter of intent to underline or to “advertise” policy reforms that have recently been made and those that are expected to be made in the near future—even if those reforms are predominantly “home grown.”

Table 5.5 **Number of Structural Policy Commitments in IMF Programs with Three Asian Crisis Countries, 1999–2000**

| | | | | | | | | | | | | | |
|-------------|----------|----------|----------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Indonesia | 10/97 | 01/98 | 04/98 | 06/98 | 07/98 | 09/98 | 10/98 | 11/98 | 03/99 | 05/99 | 07/99 | 01/00 | 07/00 |
| | 28 | 31 | 140 | 109 | 96 | 68 | 62 | 74 | 35 | 33 | 29 | 42 | 41 |
| South Korea | 12/08/97 | 12/05/97 | 12/24/97 | 02/98 | 05/98 | 07/98 | 11/98 | 08/99 | 11/99 | 07/00 | | | |
| | 29 | 33 | 50 | 53 | 51 | 39 | 53 | 83 | 94 | 68 | | | |
| Thailand | 08/97 | 11/97 | 02/98 | 05/98 | 08/98 | 12/98 | 08/99 | 09/99 | | | | | |
| | 26 | 24 | 21 | 73 | 50 | 69 | 8 | 9 | | | | | |

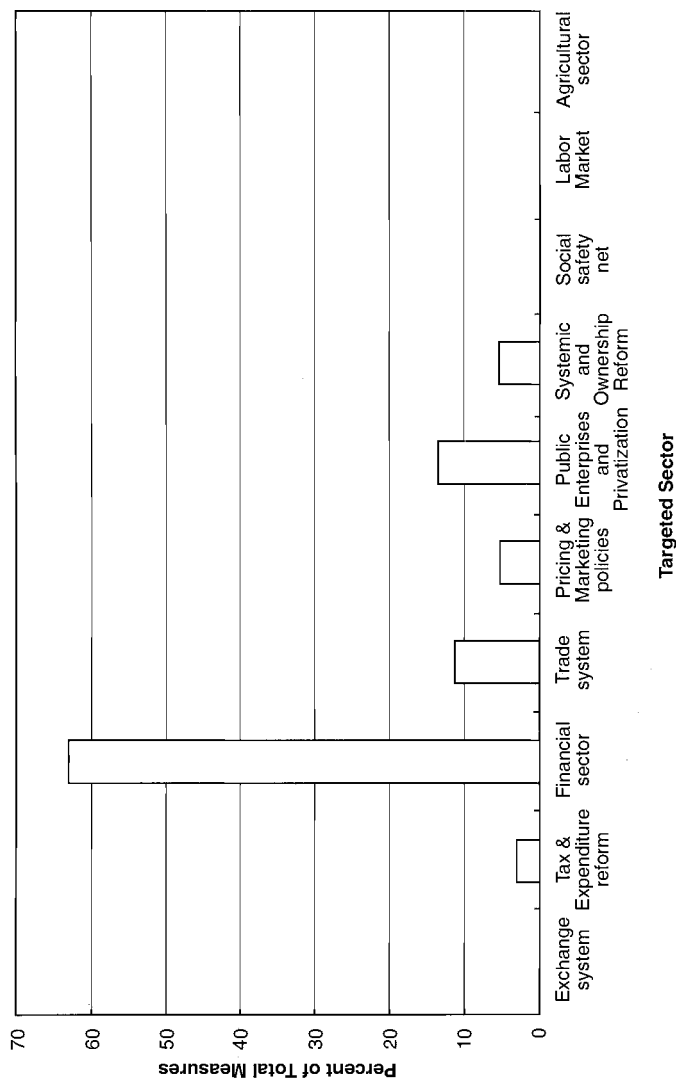


Fig. 5.2 The coverage of structural conditionality in stand-by and extended arrangements in Korea, Indonesia, and Thailand, 1996-99

List C

Indonesia: Excerpts from Structural Policy Conditions

Policy Action

Fiscal Issues

- Remove VAT exemption arrangements.
- Increase proportion of market value of land and buildings assessable for tax to 40 percent for plantation and forestry.
- Introduce single-taxpayer registration number.
- Increase non-oil tax revenue by raising annual audit coverage, developing improved VAT audit programs, and increasing recovery of tax arrears.
- Increase in two stages excise taxes on alcohol and tobacco to reflect exchange rate and price developments.
- Raise profit transfers to the budget from state enterprises, including Pertamina.
- Raise prices on rice, sugar, wheat flour, corn, soybean meal, and fish meal.
- Eliminate subsidies on sugar, wheat flour, corn, soybean meal, and fish meal.
- Accelerate provisions under the Nontax Revenue Law of May 1997, to require all off-budget funds to be incorporated in budget within three years (instead of five years).
- Incorporate accounts of Investment Fund and Reforestation Fund within budget.
- Ensure reforestation funds used exclusively for financing reforestation programs.
- Central government to bear cost of subsidizing credit to small-scale enterprises through state banks.
- Cancel twelve infrastructure projects.
- Discontinue special tax, customs, or credit privileges granted to the National Car.
- Phase out local content program for motor vehicles.
- Abolish compulsory 2 percent after-tax contribution to charity foundations.
- Discontinue budgetary and extrabudgetary support and privileges to IPTN (Nusantara Aircraft Industry) projects.
- Conduct revenue review with Fund assistance.

Monetary and Banking Issues

- Provide autonomy to BI in formulation of monetary and interest rate policy.
- Publish key monetary data on a weekly basis.
- Submit to Parliament a draft law to institutionalize BI's autonomy.

- Submit draft amendment to banking law to Parliament.
- Provide autonomy to state banks to adjust interest rates on credit and deposit liabilities, within any guidelines applying to all banks.
- Impose limits on and phase out BI credits to public agencies and public-sector enterprises.
- Strengthen BI's bank supervision department and strengthen enforcement of regulations.
- Upgrade the reporting and monitoring procedures for foreign exchange exposures of banks.
- Appoint high-level foreign advisors to BI to assist in the conduct of monetary policy.
- Set minimum capital requirements for banks of Rp 250 billion by end of 1998, after loan loss provisions.
- Reduce the minimum capital requirements for existing banks.
- Make loan loss provisions fully tax deductible, after tax verification.
- Establish program for divestiture of BI's interests in private banks.
- Require all banks to prepare audited financial statements.
- Require banks to publish regularly more data on their operations.
- Lift restrictions on branching of foreign banks.
- Submit to Parliament a draft law to eliminate restrictions on foreign investments in listed banks and amend bank secrecy with regard to non-performing loans.
- Eliminate all restrictions on bank lending except for prudential reasons or to support cooperatives or small-scale enterprises.

Bank Restructuring

- Close sixteen nonviable banks.
- Replace the closed banks' management with liquidation teams.
- Compensate small depositors in the sixteen banks.
- Place weak regional development banks under intensive supervision by BI.
- Provide liquidity support to banks, subject to increasingly restrictive conditions.
- Provide external guarantee to all depositors and creditors of all locally incorporated banks.
- Establish Indonesia Bank Restructuring Agency (IBRA).
- Determine uniform and transparent criteria for transferring weak banks to IBRA.
- Transfer fifty-four weak banks to IBRA.
- Transfer claims resulting from past liquidity support from BI to IBRA.
- Transfer to IBRA control of seven banks accounting for more than 75 percent of past BI liquidity support and seven banks that have borrowed more than 500 percent of their capital.
- IBRA will continue to take control of or freeze additional banks that fail

- to meet liquidity or solvency criteria. Where necessary, any such action will be accompanied by measures to protect depositors or creditors in line with the government guarantee.
- Issue presidential decree to provide appropriate legal powers to IBRA, including its asset management unit.
- Take action to freeze, merge, recapitalize, or liquidate the six banks for which audits have already been completed.
- Establish independent review committee to enhance transparency and credibility of IBRA operations.
- Conduct portfolio, systems, and financial reviews of all IBRA banks as well as major non-IBRA banks by internationally recognized audit firms.
- Conduct portfolio, systems, and financial reviews of all other banks by internationally recognized audit firms.
- Announce plan for restructuring state banks through mergers, transfers of assets and liabilities, or recapitalization prior to privatization.
- Ensure that state banks sign performance contracts, prepared by the Ministry of Finance with World Bank assistance.
- Merge two state-owned banks and conduct portfolio reviews of the two banks.
- Draft legislation enabling state bank privatization.
- Introduce private-sector ownership of at least 20 percent in at least one state bank.
- Prepare state-owned banks for privatization.
- Develop rules for the Jakarta Clearing House that will transfer settlement risk from BI to participants.
- Introduce legislation to amend the banking law in order to remove the limit on private ownership of banks.
- Introduce deposit insurance scheme.
- Establish Financial Sector Advisory Committee to advise on bank restructuring.
- Declare insolvency of six private banks intervened in April and write down shareholder equity.
- Issue government bonds to Bank Negara Indonesia at market-related terms to finance transfer of deposits of banks frozen in April.
- Initiate first case of an IBRA bank under the new bankruptcy law.

Foreign Trade

- Reduce by 5 percentage points tariffs on items currently subject to tariffs of 15 to 25 percent.
- Cut tariffs on all food items to a maximum of 5 percent.
- Abolish local content regulations on dairy products.
- Reduce tariffs on nonfood agricultural products by 5 percentage points.
- Gradually reduce tariffs on nonfood agricultural products to a maximum of 10 percentage points.

- Reduce by 5 percentage points tariffs on chemical products.
- Reduce tariffs on steel/metal products by 5 percentage points.
- Reduce tariffs on chemical, steel/metal, and fishery products to 5–10 percent.
- Abolish import restrictions on all new and used ships.
- Phase out remaining quantitative import restrictions and other nontariff barriers.
- Abolish export taxes on leather, cork, ores, and waste aluminum products.
- Reduce export taxes on logs, sawn timber, rattan, and minerals to a maximum of 30 percent by 15 April 1998; 20 percent by end of December 1998; 15 percent by end of December 1999; and 10 percent by end of December 2000.
- Phase-in resource rent taxes on logs, sawn timber, and minerals.
- Replace remaining export taxes and levies by resource rent taxes as appropriate.
- Eliminate all other export restrictions.
- Remove ban on palm oil exports and replace by export tax of 40 percent. The level of the export tax will be reviewed regularly for possible reduction, based on market prices and the exchange rate, and reduced to 10 percent by end of December 1999.

Investment and Deregulation

- Remove the 49 percent limit on foreign investment in listed companies.
- Issue a revised and shortened negative list of activities closed to foreign investors.
- Remove restrictions on foreign investment in palm oil plantations.
- Lift restrictions on foreign investment in retail trade.
- Lift restrictions on foreign investment in wholesale trade.
- Dissolve restrictive marketing arrangements for cement, paper, and plywood.
- Eliminate price controls on cement.
- Allow cement producers to export with only a general exporters license.
- Free traders to buy sell and transfer all commodities across district and provincial boundaries, including cloves, cashew nuts, and vanilla.
- Eliminate BPPC (Clove Marketing Board).
- Abolish quotas limiting the sale of livestock.
- Prohibit provincial governments from restricting trade within and between provinces.
- Enforce prohibition of provincial and local export taxes.
- Take effective action to allow free competition in the following:
 1. importation of wheat, wheat flour, soybeans, and garlic
 2. sale or distribution of flour
 3. importation and marketing of sugar
- Release farmers from requirements for forced planting of sugar cane.

The tale told by table 5.5 and by figure 5.2 can be summarized as follows. First, the number of structural policy conditions included in these programs with the three Asian crisis economies is very large (if not totally unprecedented)—many more than you can count using all your fingers and toes.²² Without claiming any precision, my count from publicly available documents is that these structural policy commitments summed, at their peak, about 140 in Indonesia, over 90 in Korea, and over 70 in Thailand. Each of these totals is considerably above the average of about 50-plus for all Fund programs over the 1996–99 period. Second, in the programs with Korea and Thailand, the number of structural policy conditions was considerably smaller at the beginning of the program than at its peak—perhaps because the country authorities and the Fund first laid out the main elements of the structural reform package and then filled in the details as they went along, and because implementation of reforms was pretty good (see discussion below). In contrast, the number of structural policy conditions in the Fund program with Indonesia hits its peak pretty early on and then declines as the program period goes on, perhaps reflecting an initial effort to impress the markets with the extent of intended structural reform and then scaling that back as market reaction proved disappointing and as evidence accumulated that implementation capacity or willingness would be lower than anticipated. Third, although financial-sector restructuring and supervision is the dominant policy concentration in all three programs, additional data indicate that the scope of structural policy conditionality is much narrower in the Korean and Thai programs than in the Indonesian one. Putting aside the financial sector, Thai structural policies are mainly focused on tax and expenditure reform and on corporate debt restructuring. In Korea, the non-financial areas getting most attention are corporate governance and restructuring (and some trade and capital-account liberalization). In Indonesia, structural reforms outside the financial sector are more of a mixed bag, with significant commitment clusters appearing for privatization and reform of public enterprises, for trade systems, for pricing and marketing policies, for corporate restructuring, and for tax and expenditure reform; there are also minor clusters for energy and environmental policies and for social safety nets.

Turning to list C, what is striking is the number, scope, and detail of the structural policy commitments made by Indonesia, including in nontraditional areas of conditionality. There are, *inter alia*, measures dealing with reforestation programs; the phasing-out of local content programs for motor vehicles; discontinuation of support for a particular aircraft project and of special privileges granted to the National Car; abolition of the compul-

22. I hesitate to call the total number of structural policy conditions in even the Indonesian program “unprecedented” because I am told informally that there was a larger figure (close to 200) in one of Russia’s programs with the Fund.

sory 2 percent after-tax contribution to charity foundations; appointment of high-level advisors for monetary policy; development of rules for the Jakarta Clearing House; the end of restrictive marketing agreements for cement, paper, and plywood; the elimination of the Clove Marketing Board; the termination of requirements on farmers for the forced planting of sugar cane; the introduction of a micro credit scheme to assist small businesses; and the raising of stumpage fees. Enough to say that the great bulk of such measures were *not* included because of their macroeconomic impact; they were presumably included instead for anticorruption reasons, to instill confidence in private investors that the system was changing, to facilitate monitoring of commitments, and (for some commitments) to reflect the structural policy agendas of either other IFIs (the World Bank and the Asian Development Bank) or certain creditor countries (see discussion in section 5.1.4).²³

Number of Structural Benchmarks in Fund Programs with the Transition Economies

Mercer-Blackman and Unigovskaya (2000) have analyzed the use of SBMs in Fund programs for twenty-five transition economies over the 1989–97 period. Their tally, also derived from the Fund’s MONA database, is presented in table 5.6. Three observations merit explicit mention.

First, the average number of SBMs per program is roughly twice as high in ESAF (twenty-six) and EFF (twenty-three) arrangements and as it is for standby arrangements (thirteen). Second, although the data in table 5.7 are not directly comparable with those in table 5.1 (not only are the time periods different, but the latter include all structural conditions, whereas the former include only SBMs), the number of SBMs in standby arrangements for the transition economies do not seem far out of line (i.e., higher) with the recent averages for SBAs in all Fund programs—and they are clearly much lower than the averages on SBMs in the three Asian crisis economies. Third, there is more variation for SBAs in the number of SBMs (ranging from one in Bulgaria and Latvia to thirty-five in Armenia) than for either ESAF or EFF arrangements.

Figure 5.3, taken from Christiansen and Richter (1999), gives the breakdown by policy area of structural policy conditions for the fund’s programs with the transition economies.²⁴ The main message is that the most frequently occurring structural conditions were in the area of public-sector management (institutional reform, tax and revenue policy, expenditure policy, and public wages and employment). Next in line were restructuring and

23. Haggard (2000) shares this view.

24. The data used to construct figure 5.3 are different from those used in table 5.8. The former cover (I think) all structural policy conditions (not just SBMs) and they also cover the Fund’s initial programs with the transition economies under the (lower-conditionality) Systemic Transformation Facility. These differences, however, are not important for our purposes.

Table 5.6 **Number of Structural Benchmarks (SBs) According to Structural Benchmark Groups for Countries in Transition**

| | Type of Fund Program | Number of Structural Benchmarks |
|-----------------|----------------------|---------------------------------|
| Armenia | SBA | 35 |
| Azerbaijan | SBA | 26 |
| Belarus | SBA | 21 |
| Bulgaria | SBA | 19 |
| Macedonia | SBA | 19 |
| Romania | SBA | 19 |
| Estonia | SBA | 18 |
| Georgia | SBA | 17 |
| Hungary | SBA | 15 |
| Romania | SBA | 15 |
| Poland | SBA | 14 |
| Kazakhstan | SBA | 13 |
| Moldova | SBA | 13 |
| Ukraine | SBA | 12 |
| Uzbekistan | SBA | 12 |
| Croatia | SBA | 11 |
| Kazakhstan | SBA | 11 |
| Ukraine | SBA | 11 |
| Bulgaria | SBA | 8 |
| Kyrgyz Republic | SBA | 6 |
| Russia | SBA | 6 |
| Moldova | SBA | 5 |
| Poland | SBA | 3 |
| Latvia | SBA | 2 |
| Bulgaria | SBA | 1 |
| Latvia | SBA | 1 |
| Average | | 13 |
| Kyrgyz Republic | ESAF | 35 |
| Albania | ESAF | 34 |
| Azerbaijan | ESAF | 31 |
| Georgia | ESAF | 22 |
| Armenia | ESAF | 18 |
| Macedonia | ESAF | 17 |
| Average | | 26 |
| Azerbaijan | EFF | 41 |
| Russia | EFF | 37 |
| Kazakhstan | EFF | 23 |
| Moldova | EFF | 16 |
| Lithuania | EFF | 11 |
| Croatia | EFF | 9 |
| Average | | 23 |

Table 5.7 **Percentage of IMF Loan Actually Disbursed under Each Arrangement (distribution by quartiles)**

| | $x < 0.25$ (1) | $0.25 \leq x < 0.50$ (2) | $0.50 \leq x < 0.75$ (3) | $0.75 \leq 1.0$ (4) | Fully Disbursed ($x = 1.0$) (5) | (4) + (5) $0.75 \leq x$ (6) | Number of Arrangements (7) |
|-----------------------|-------------------|-----------------------------|-----------------------------|------------------------|---|-----------------------------------|----------------------------------|
| All arrangements | | | | | | | |
| 1973-77 | 36.5 | 7.1 | 5.9 | 5.9 | 44.7 | 50.6 | 85 |
| 1978-82 | 19.4 | 16.1 | 10.5 | 12.9 | 41.1 | 54.0 | 124 |
| 1983-87 | 12.9 | 15.8 | 19.4 | 7.9 | 43.9 | 51.8 | 139 |
| 1988-92 | 17.5 | 15.1 | 20.6 | 14.3 | 32.5 | 46.8 | 126 |
| 1993-97 | 27.0 | 19.1 | 26.2 | 11.3 | 16.3 | 27.6 | 141 |
| Full period (1973-97) | 21.6 | 15.3 | 17.6 | 10.7 | 34.8 | 45.5 | 615 |
| Stand-by | 23.1 | 13.4 | 15.0 | 9.5 | 39.0 | 48.5 | 441 |
| EFF | 33.3 | 22.2 | 19.0 | 15.9 | 9.5 | 25.4 | 63 |
| SAF/ESAF | 9.0 | 18.9 | 27.0 | 12.6 | 32.4 | 45.0 | 111 |

Source: IMF, Transactions of the Fund (1998).

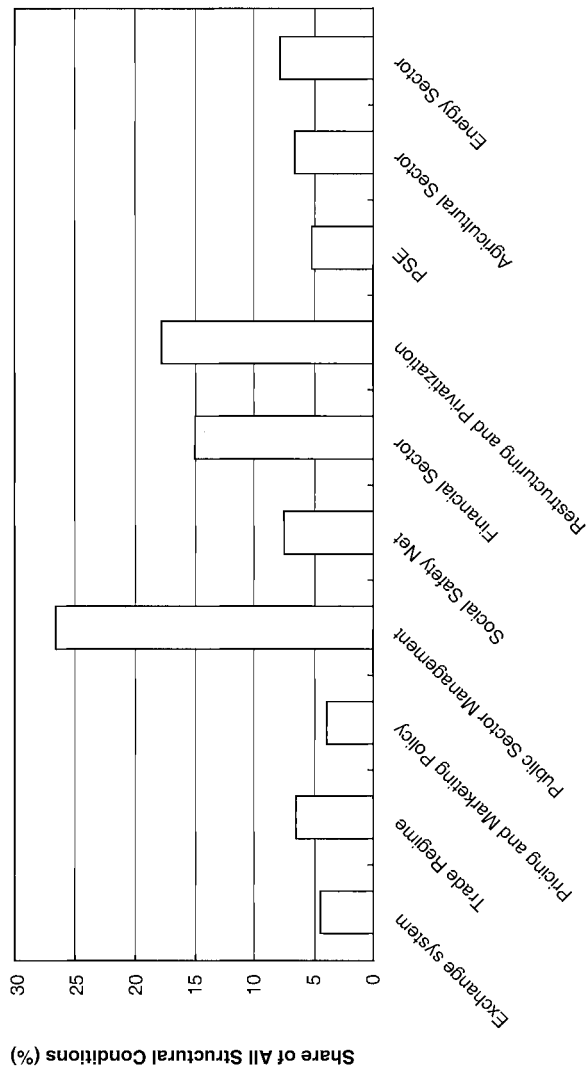


Fig. 5.3 Distribution of structural conditions in IMF-supported programs: Transition economies

privatizations, and financial-sector reforms. After that, we see a fairly even distribution across the remaining areas (energy sector, social safety net, agricultural sector, trade regime, exchange system, etc.). The top three categories accounted together for over two-thirds of structural conditions.

Scattered Evidence on Number of Structural Benchmarks in Earlier SAF Programs

An unpublished IMF study (1987) of seventeen SAF arrangements (for low-income countries) in 1986–87 also looked at the number and distribution of structural benchmarks. The main findings were that the average number of SBMs per SAF arrangement was about seven, that there was considerable variation around this average across programs (ranging from three in the program for Bolivia to fifteen for Uganda), and that structural conditions also ranged quite widely across policy areas (covering the exchange system, trade liberalization and tariff reform, public enterprises, tax and expenditure policy, producer pricing and agricultural marketing, and public-sector investment programs).

To sum up, structural policy conditionality is now a common and important element of Fund conditionality. When prior actions, performance criteria, structural benchmarks, and conditions for program reviews are combined, it has been typical (over the past few years) for a one-year standby arrangement to have on the order of, say, a dozen structural conditions and for a three-year EFF arrangement to have, say, fifty of them. About two-thirds of those structural conditions are apt to fall in the areas of fiscal policy, financial-sector reform, and privatization, with the remainder scattered across a fairly wide field. The structural conditions in the Fund's much-discussed programs with three Asian crisis economies (Indonesia, Korea, and Thailand) were much more numerous and detailed than is usually the case. Financial-sector conditions dominated in all three of those Asian programs, but detailed conditions in quite a few noncore structural policy areas were also evident, especially in the case of Indonesia. Although much of the external criticism of Fund structural conditionality has emphasized the wide scope of the Fund's involvement (e.g., some wonder what the Fund has to do with the clove monopoly), our review of the evidence suggests that the number and specificity of conditions in core areas ("micro management") are at least as important an issue.²⁵

Those analyzing Fund structural policy conditionality, including researchers both inside and outside the Fund, are unanimous in concluding that there has been a pronounced upward trend in such conditionality over the past fifteen years, and this trend has probably become steeper in

25. Saying that the Fund has micromanaged some structural reforms is not the same as saying that such reforms necessarily lack macroeconomic impact. For example, a condition to reduce significantly the extent of wage indexation could be very detailed but might still carry macro impact.

the 1990s.²⁶ The evidence reported in this section (much of it previously unpublished) strongly corroborates this conclusion. Finally, there has also been a shift over time in the instruments used by the Fund to monitor structural conditionality, with resort to structural benchmarks, conditions for program reviews, and prior actions having risen faster than formal performance criteria. Prior to the 1980s, the Fund was hesitant to ask for prior actions, and performance reviews regarding structural policies were exceptional for standby arrangements (see Polak 1991; IMF 1987). Structural benchmarks were apparently not used prior to the establishment of the SAF in 1986. As demonstrated earlier, all this is no longer the case. For example, a comparison of the average number of structural conditions for standby arrangements in 1996–99 in table 5.1 with the figures on structural performance criteria in table 5.2 suggests that, taken together, structural benchmarks, prior conditions, and program reviews have recently been about five times as numerous as structural performance criteria.

Writing well before Fund programs with the Asian crisis countries, Polak (1991) contrasted the principles put forth in the 1979 Guidelines on Conditionality with actual practice:

The guidelines do not attempt to change the structure of conditionality: their aim is limited to making that structure less intrusive by limiting the number of performance criteria, insisting on their macroeconomic character, circumscribing the cases for reviews, and keeping preconditions to a minimum. Yet these restraining provisions have not prevented the intensification of conditionality in every direction that the guidelines attempted to block. (61)

Nine years later, it's hard to disagree with that assessment.

The Effectiveness of Fund Structural Policy Conditionality

If we take it as given that the IMF has become more “grandmotherly” or intrusive with regard to its structural policy conditionality, the next question is how effective such conditionality has been.²⁷ Here, we address just two aspects of that question: the degree of compliance with Fund conditions and the quality of the Fund policy advice implicitly reflected in such structural policy conditionality. Again, much of the available evidence is often not in the form best suited to the focus of this paper (that is, it refers to compliance with, or the effectiveness of, *all* Fund policy conditions, not just structural policies, or when it deals only with structural policies, it covers only low-income or transition economies). Nevertheless, some conclusions

26. See, for example, Tanzi (1987), Polak (1991), Killick (1995), James (1998), Krueger (1998), Mussa and Savastano (1999), and Gupta et al. (2000).

27. The description of Fund conditionality as being “grandmotherly” is from Keynes; see James (1998).

can be put forward. In addition, some of the recent research on compliance with structural conditions in Fund programs with the transition economies is particularly interesting.

Compliance with Fund Policy Conditions

Clearly, Fund policy conditionality cannot have its intended effects if countries do not implement these policies. Two measures of compliance are typically found in the literature: the share of IMF loans actually disbursed, and the degree of compliance with particular Fund policies (e.g., credit ceilings, budget deficits, various structural benchmarks).²⁸

Table 5.7, adopted from Mussa and Savastano (1999), shows the share of Fund lending actually disbursed for 615 Fund programs over the 1973–97 period. Although the authors caution that a low disbursement share could mean the program was so successful—or conditions improved so rapidly—that the country needed to use only a fraction of the committed IMF financing, they conclude that low disbursement cases mainly were ones in which the program went off track (because policies deviated significantly from those agreed upon and subsequent negotiations failed to reach agreement on a modified program).

Here, it is appropriate to highlight three of the Mussa-Savastano findings. First, if we take, say, disbursement of 75 percent or more of the total loan as implying close adherence to IMF policy conditionality, then less than half (45.5 percent) of all Fund arrangements over the entire 1973–97 period would have met that test; see column (6) in table 5.7. Second, again using the 75 percent or greater benchmark, the completion rate for standby arrangements (48.5 percent) was notably higher than that for EFF programs (25.4 percent) with higher average structural policy content; the completion rate for SAF/ESAF arrangements, which also have a relatively high structural policy content and deal exclusively with low-income countries, was much higher than for EFFs and only slightly below that for SBAs. Third, there is a suggestion that the completion rate for Fund programs is declining over time.²⁹

A very similar exercise on completion rates was undertaken by Killick (1995) for 305 Fund programs over the 1979–93 period, with results quite close to those obtained by Mussa and Savastano (1999). Killick defines a “completed program” as one that disbursed 80 percent or more of the total Fund loan. He finds on this measure that 47 percent of Fund programs were completed, that the completion rate was higher for SBAs than for EFFs, that the completion rate was declining over time, and that completion rates

28. Another potential measure of compliance would be the share of programs that saw an early conversion of the program to a precautionary arrangement.

29. I use the term “suggestion,” because Mussa and Savastano (1999) note that the results on completion rates for the 1993–97 period are biased downward due to the inclusion of arrangements with post-1997 expiration dates.

do not differ (in the expected way) on account of cross-country differences in either per capita income or type of export.³⁰

Most earlier studies that looked at compliance with particular Fund policies were restricted to macro conditionality. In brief, Beveridge and Kelly (1980) and Edwards (1989) found that compliance with monetary or fiscal performance criteria was observed in approximately 48–62 percent of Fund programs. Polak (1991) updated these results for SBA, EFF, and SAF programs in the 1980s and found that compliance rates for the 1980s were below those for the 1970s. Killick (1995) cites one unpublished 1991 IMF study that looked at compliance with structural policies in SAF and ESAF programs: slightly over half of all structural benchmarks were observed on schedule (or two-thirds within a few months thereafter), and compliance was relatively high for agricultural producer pricing and marketing and for financial reforms, and relatively low for fiscal provisions (and especially for public enterprise reforms).

Two more recent studies of compliance with fund structural conditionality have been conducted for the transition economies by Christiansen and Richter (1999) and Mercer-Blackman and Unigovskaya (2000).³¹ Four of their findings are of interest. First, the on-time compliance rate for structural benchmarks as a group averaged 42 percent, with an additional 16 percent of conditions met with delay; the remaining 42 percent of conditions were not met or no information was available. Second, the compliance rate for performance criteria (both macro and structural taken together) was higher than that for structural benchmarks. Third, the correlation between the number of structural benchmarks in a program and the completion rate for those structural policies was negative, although neither large nor statistically significant. Fourth, although there was sizable variation in the compliance rate across structural reform categories, the standard deviation of compliance across countries was more than twice as great as that for compliance by reform category.³²

To sum up, existing studies suggest that obtaining compliance with Fund conditionality has been a serious problem, including the Fund's structural policy conditionality. The compliance problem has been getting more serious over time. Compliance has been lower for EFF programs than for standby arrangements (but not apparently for SAF/ESAF programs).

30. Killick (1995) did find some evidence that completion rates were lower for highly indebted countries and for those that received relatively low access to Fund resources.

31. A caveat should be noted with respect to studies of the transition economies. Because of the centrality of structural policies to their reform efforts in the 1990s, their experience with structural policy conditionality may be "special" and not necessarily transferable to economies where structural policies occupy a less central role.

32. The on-time compliance rate was highest (57 percent) for public wage and employment conditions and lowest (29 percent) for price and marketing conditions. Ukraine had the lowest overall compliance rate (14 percent of structural conditions met on time), while Lithuania had the highest (82 percent).

Compliance has also been lower for structural benchmarks than for performance criteria. Correlations between the compliance rate and the number of structural conditions, along with measures of the variability of compliance across program areas and countries, suggest that greater selectivity both in the countries approved for structurally oriented programs and in the structural measures included in such programs could have a high payoff in terms of compliance rates.³³ Further studies on a broader sample of countries would be useful in sharpening these conclusions, including the important issue of whether or not the product of the number of structural conditions and the compliance rate is approximately a constant.

Effectiveness of Structural Policy Conditionality

Even if countries consistently complied with Fund structural policy conditions, this would not necessarily constitute an endorsement for such conditionality unless it can be shown that these are “good” structural policy requirements that lead to “better” economic performance. Evidence relevant for answering that latter query can be gleaned from at least five sources: (a) econometric studies that estimate the effects of IMF programs (as a whole) by comparing program and nonprogram countries or periods; (b) studies that relate either structural policy action within a Fund program or structural policy action more generally (whether in Fund programs or otherwise) to economic growth; (c) studies that relate measures of corporate governance to the extent of exchange rate depreciation or stock market decline during the Asian crisis; (d) a comparison of Fund structural policy recommendations with the “consensus” of the economics profession on what structural policies are good; and (e) a review of the Fund’s structural policy recommendations in the Asian crisis countries.

Studies on the Effects of IMF Programs as a Whole. By now, there is an extensive empirical literature on the effects of IMF programs.³⁴ If one defines “program effects” as the observed outcome (for growth, inflation, the balance of payments, etc.) relative to the counterfactual (that is, the outcome in the absence of an IMF program), then it is clear that most of the early literature had serious methodological flaws (see Goldstein and Montiel 1986). Before-and-after comparisons are not reliable because they attribute all the change in outcomes to a Fund program when exogenous shocks and other influences may really be causing that change. Comparison of program targets and outcomes will not be useful when program targets are set too ambitiously or not ambitiously enough. Simulations of economic models can

33. It is relevant to note that the 1979 “Conditionality Guidelines” suggest that the managing director of the IMF should only recommend that the Fund’s executive board approve a program when it is his judgment that the program . . . will be carried out”; see Guideline Number 7 in appendix B.

34. For a recent survey of this literature, see Haque and Khan (1998).

tell us something about the effect of Fund-type policies but not about the effects of actual Fund programs, and comparisons of outcomes for program and nonprogram countries will not do the job if the two groups differ systematically in ways that matter for economic performance. Over time, most of these methodological problems have been addressed. Nowadays, studies typically seek to identify program effects after controlling both for nonprogram effects and for observed (precrisis) differences between program and nonprogram countries.

Still, even the best studies have only indirect implications for the effectiveness of Fund structural policy conditionality since they do not disaggregate the contents of a Fund program into its macro and structural policy components. In any case, what such studies usually find is that Fund programs have a favorable impact on the current account and overall balance of payments, that the effect on inflation is statistically insignificant, and that the effect on economic growth is initially (with the first year) negative but probably turns positive at longer time horizons (see Mussa and Savastano 1999; Fischer 2000a; Conway 1994); too little econometric work has been done on income distribution to say much.³⁵

One possible explanation for why such studies do not generate large positive growth effects for Fund programs is that compliance with the policies that matter for medium- to long-run growth is far from complete (as demonstrated above); also, some countries that are in trouble implement their own policies that are not very different from those included in Fund programs. It has also been argued that even nonprogram countries have been influenced by the “silent revolution” in economic thinking on the importance of sound macroeconomic and structural policies and that the Fund has contributed importantly to this revolution (that is, nonprogram countries are not a good “control group” because they too are affected by the policy treatment; see, e.g., Krueger 1998). A second explanation is that the lags associated with the effects of structural policies on economic growth are long and, hence, may show up only after the country has left a Fund program. Yet a third explanation is that the results are right: despite all the rhetoric on “growth-oriented adjustment,” Fund programs are still mainly about getting out of financial crises and don’t much matter for growth in the medium to long run.

Links between Broad Measures of Structural Policy Reform and Growth. This is a more recent literature, much of it connected with understanding the economic performance of the transition economies.³⁶

35. See, however, the recent study by Garuda (2000) who finds that Fund programs improve income distribution and poverty reduction for countries with relatively modest precrisis external disequilibria but worsen them for countries with severe precrisis external imbalances.

36. There is of course a much broader and older literature on effects of alternative structural-policy strategies (e.g., Balassa’s [1983] work on outward-looking vs. inward-looking policy

One strand looks at whether greater compliance with Fund structural policy conditionality is associated with better growth performance. Here, the recent study by Mercer-Blackman and Unigovskaya (2000) is worth noting. They find that, after controlling for other factors, those transition economies that demonstrated higher compliance with IMF structural performance criteria had better records of sustained economic growth (defined as three consecutive years of positive real GDP growth); in contrast, they could find no significant association between compliance with Fund structural benchmarks and sustained growth. They also report that transition economies that did better on complying with Fund structural performance criteria also showed greater progress on implementing structural reform more generally.³⁷ One interpretation of their first finding is that the (relatively few) structural policies included as performance criteria are more important for growth than the larger number regarded as structural benchmarks. The authors concede that some of their results are also consistent with other views; for example, countries with better growth performance may find it easier to implement Fund structural conditions, and the unobserved “commitment to reform” may explain *both* Fund program implementation and progress on structural policy action more generally.

The other strand of this literature tests for an association between structural reform—whether achieved within the context of a Fund program or not—and economic growth. A good example is the recent study by Havrylyshyn et al. (1999), which examines the growth experience of twenty-five transition economies over the 1990–97 period. After attempting to hold other determinants of growth constant (including initial economic conditions, inflation, size of government, degree of openness, etc.), they find that the greater was progress on an index of overall structural reform, the higher was economic growth.³⁸ They also tested whether individual components of structural reform aided growth but found that only price liberalization had significant explanatory power when the overall reform index was also included—a finding that they interpret as suggesting that it is the combination of structural policies that is more critical for growth than any single type of policy.

strategies) and on the determinants of growth in developing countries more generally (e.g., Barro [1996]). In addition, there are many studies that take a nonquantitative approach to evaluating Fund structural policies; see, for example, Schadler et al. (1995a), who (looking at Fund programs during the 1988–92 period) concluded that “there was a broad measure of success in accomplishing structural reform” (29).

37. Progress on structural reform is measured using a structural reform index, derived from De Melo, Deniz, and Gelb [1996] and EBRD Transition reports. This index is meant to capture liberalization of prices and foreign exchange markets, small and large-scale privatization, governance and restructuring reforms, legal reforms, interest rate liberalization, and banking reforms; see Havrylyshyn et al. [1999].

38. Fischer, Sahay, and Vegh (1996) reached a similar conclusion in an earlier paper on the growth experience of the transition economies. Because there are very few transition economies that have not had a program with the IMF, a comparison of program and nonprogram countries is not a viable research strategy.

A similar growth exercise for eighty-four low- and middle-income countries during the 1981–95 period is summarized in IMF (1997). In these pooled, cross-section regressions, the authors find that after controlling for other determinants of per capita GDP growth, improved macroeconomic policies and improved structural policies both have significant effects on growth in the expected direction. They also conclude that behavior of growth in ESAF countries does not differ fundamentally from that in other developing countries.

Corporate Governance and the Asian Financial Crisis. As suggested earlier, there has been much discussion of the role that governance and corruption issues played in the Asian financial crisis. A new study by Johnson et al. (2000) provides some interesting empirical results and insights. The authors look at the behavior of nominal exchange rates and stock markets from the end of 1996 through January 1999 for twenty-five emerging economies. Their aim was to see if cross-country differences in measures of corporate governance (e.g., judicial efficiency, corruption, rule of law, protection for minority shareholders, creditor rights, etc.) could do a better job at explaining the extent of exchange rate depreciation and stock market decline than could standard macroeconomic measures (e.g., fiscal and monetary policy, current account imbalances, international reserves, foreign debt, etc.). In brief, they find that the corporate governance horse does better than the macroeconomic horse, particularly for stock market movements. They argue that institutions that protect investor rights are not important as long as growth lasts (because managers do not want to steal). However, when growth prospects decline and there is even a small loss of investor confidence, countries with only weakly enforceable minority shareholder rights become particularly vulnerable. This is because outside investors reassess the likely amount of expropriation by managers and adjust the amount of capital they are willing to provide (resulting in a fall of asset values and a collapse of the exchange rate). On some of Johnson et al.'s measures of corporate governance—particularly rights of minority shareholders—several Asian crisis countries (particularly Indonesia and Thailand) ranked low and hence were more vulnerable to the effects of a downturn.

Fund Structural Policy Conditionality and the “Consensus.” In 1983 at a conference on IMF conditionality, Richard Cooper [1983] offered the following view: “we could choose any five people present and make a team to work up an economic adjustment program for a particular country other than our own . . . [and] the program we came up with would not differ greatly from a typical IMF program” (571).

I am more skeptical that we could make the same statement today, at least about Fund programs for the Asian crisis countries. Nevertheless, I would still maintain that the general thrust of the Fund's structural policy recom-

mendations falls squarely in what my IIE colleague John Williamson (1990) has labeled “the Washington policy consensus.” Whether it is interest rate deregulation, trade liberalization, tax reform, the currency regime, foreign direct investment, price liberalization, or banking reform, Fund structural policy advice is typically not far from the consensus. Writing fifteen years after Cooper, Anne O. Krueger (1998, p. 1998) offers a similar assessment:

Many of the lending changes supported by the Bank and the Fund (in, for example, exchange rates, size of fiscal deficits, trade liberalization, agricultural and energy price reforms, privatization, and tax reform) are ones that would be endorsed in broad outline, if not in detail, by almost all economists.

But saying that the Fund’s structural policy advice has generally reflected the profession’s consensus view does not mean that this advice has not at times gone seriously astray. Three examples illustrate the point. First, along with several of its larger G7 shareholders (particularly the United States and the United Kingdom), the Fund often pushed hard on emerging economies to undertake capital account liberalization without due regard to the adequacy of the host country’s regulatory and supervisory framework.³⁹ In Korea, for instance, the Fund apparently urged liberalization of both short-term and long-term flows. However, when the Koreans said they would only go for the former, the Fund apparently regarded this as better than nothing and accepted it.⁴⁰ A second example concerns Fund advice on privatization in transition economies. There, the IMF (2000) acknowledges that privatization runs the danger of producing perverse results in the absence of hard budget constraints, competition, and effective standards of corporate governance. As with capital account liberalization, a more selective approach to privatization with greater attention to sequencing would, with the benefit of hindsight, have been better. Yet a third example was the initial Fund recommendation in Indonesia to go with a limited deposit guarantee for banks rather than a blanket guarantee.⁴¹ In drawing the lessons of the Asian crisis, the Fund (Lindgren et al. 1999) now concludes that in a systemic crisis a blanket guarantee is needed to restore confidence in the financial system.⁴²

39. One of the few observers who stated publicly his concerns (before the crisis) about the magnitude of short-term capital inflows going into Asian emerging economies was Park (1996).

40. In appraising Fund structural policy recommendations made in the late 1980s, Schadler et al. (1995a, 31) similarly conclude: “Coordinated programs for structural reforms would have been desirable but were generally not politically or administratively feasible. It is appropriate, therefore, that programs supported the second-best strategy of seizing opportunities for reform on as broad a front as possible. This process cannot give a large role to sequencing considerations, but these are not unambiguous and could unduly slow the process.”

41. A comprehensive guarantee was introduced in Indonesia two months later.

42. As suggested below, I do not share this view on the use of blanket guarantees, but I think most others do.

Fund Structural Policy Conditionality in the Asian Crisis Countries. Because the heart of Fund structural policy conditionality in the Asian crisis countries dealt with the financial sector, and because there is already a separate paper at this conference focused on financial policies in emerging economies, I will confine my remarks on the Fund's structural policy recommendations to four points.

First, I find the underlying rationale for dealing immediately with insolvent and weak banking and finance companies compelling. Without such action, it probably would have been impossible to restore monetary and currency stability (because large-scale liquidity support to insolvent institutions would have worked at cross purposes), and the fiscal tab for bank recapitalization would have been even higher than it has turned out to be (because managers of insolvent institutions would have engaged in more "gambling for resurrection"). Moreover, I don't think confidence could have been restored without some concrete evidence that financial-sector supervision (including transparency and disclosure) was going to be started on a different path for the future than it had been on in the past. Similarly, to show that cronyism and corruption would henceforth be less prevalent, it was important (at least in Indonesia) to take a few visible privileges or sweetheart deals away from those close to President Suharto. Once the crisis deepened and nonperforming loans of banks and corporate insolvencies became larger and more widespread, it also became evident that banks and corporates—particularly in Thailand and Indonesia—would not simply be able to grow out of it without restructuring. Because of strong links between banks and corporates (especially in Korea and Indonesia), as well as the need to cushion somewhat the most vulnerable groups from the effects of the crisis, there was a good case for including some corporate reforms (e.g., reduction of debt-equity ratios by the *chaebol*) and some social safety net provisions in those programs.

Second, notwithstanding the above argument, there were elements of structural conditionality in the three Fund programs with Indonesia, Korea, and Thailand that seem superfluous. I don't find persuasive the argument that trade liberalization measures in the Indonesian and Korean programs were necessary to prevent a slide toward protectionism (see Hamann and Schulze-Ghattas 1999). A better rationale would be that trade liberalization was needed to increase competition and to help discipline inefficient domestic producers. However, that still doesn't explain why trade liberalization needed to be done immediately rather than after the crisis. Likewise, I don't see why the Indonesian program had to be so sweeping with respect to the dismantling of state monopolies and cartels, elimination of restrictive marketing agreements, abolition of showcase projects, and the like, disagreeable as those practices were. For confidence reasons, a few "candies" may have had to be taken away from cronies at the outset, but the rest of the box (and, admittedly, it was a very big box) could have waited for later. In the Korean

program, the tax reform and privatization conditions look like they could have waited until after the crisis. Additionally, in Thailand (which had the narrowest of the three programs), it's hard to see why privatization of state enterprises, removal of the real estate tax on foreign purchases of condominiums, and a new land act needed to be part of the Fund's conditions.

Moving from the width to the depth of conditionality, the level of detail reflected in the structural benchmarks for these three programs likewise seems excessive. For example, in Indonesia, was it necessary to have five commitments for reform of oil and gas policy, and eighteen commitments for follow-up actions to the findings of the audit of Bank Indonesia? In Korea, was it essential to have eleven commitments for restructuring, for investment guidelines, and for corporate governance of insurance companies? In Thailand, did six target dates have to be set up to guide the privatization of Bangkok Metropolitan and Siam City banks? More generally, did supervisory and prudential measures for financial institutions in the three crisis countries have to be specified so precisely? Wouldn't, say, a broader commitment to implement the Basel Core Principles of Effective Banking Supervision by date *x*, along with a few benchmark checks of good progress, be as effective (and less intrusive) and, in addition, carry the seal of approval of the world's key banking supervisors? Couldn't the Fund provide its very detailed views on ways of improving corporate governance as technical assistance, not as conditions in the Fund program? Yes, this would require more faith that the crisis country would want on its own to "do the right thing." However, if it doesn't really want to implement the reforms, then very detailed monitoring via a very large set of structural benchmarks may not push the ball much farther ahead. Besides, unlike performance criteria, failure to meet many of the structural benchmarks does not carry the automatic threat of interruption of fund financing.

Third, I don't agree with either the Fund or many of its critics that the Indonesian experience leads to the lesson that bank restructuring during a systemic banking crisis can only be accomplished successfully if blanket guarantees are issued by the government (see Lindgren et al. 1999). The closing of banks in Indonesia led to runs because the authorities were only willing to close a subset of a much wider group of insolvent banks, because high-level political support (from President Suharto and some others) for the initial bank closures was absent, and because the Fund agreed to a bad compromise. When there are widespread bank insolvencies, the key to restoring confidence is to convince the public that all the bad banks have been closed or resolved, that the remainder are solid, and that small retail depositors (not everybody) will be covered.⁴³ As a former colleague of mine put it, "people don't run banks that are closed; they run banks that are open

43. Ways to limit moral hazard without negating the benefits of deposit insurance are discussed in Financial Stability Forum (2000).

that they think will soon be closed.” Also, when there is no deposit insurance in place or the insurance system is not viewed as credible, the necessity is for the bank supervisory authority to replace the old management of insolvent banks with a new one (so as to prevent “double-or-nothing” behavior and even larger credit losses), and to eventually dock the shareholders (so as to penalize the owners and to limit moral hazard); such insolvent banks can then be resolved in a variety of ways (even while they honor withdrawals and take deposits). What’s not necessary—and can prompt runs—is to board up the teller cages of some banks (while other questionable banks remain open). The real lesson of the Indonesian experience is that a sensible, incentive-compatible deposit insurance system (along the lines of the Federal Deposit Insurance Corporation Improvement Act [FDICIA] in the United States) should be a permanent part of the financial infrastructure in all countries; without it, governments wind up providing *ex post* deposit insurance, but they do it at higher current cost and with moral hazard effects that increase the likelihood of future banking crises.

In much the same spirit, I disagree with those who say that bank capital requirements should have been phased in even more slowly in the Asian crisis countries so as to prevent a credit crunch. A cutback in lending exposure is an equilibrium response of a bank to a negative shock that reduces its capital. The relevant question is not whether one likes a credit crunch; it is whether one prefers some credit crunch to an expansion of lending—much of which is likely to go to the same insolvent borrowers that were at the root of the banks’ difficulties (leading to even larger bank losses). To be sure, there was a fall-off in real credit supply in late 1997 and early 1998 in most of the crisis countries, and undoubtedly some “good” borrowers were also denied credit. However, there was also a fall in real credit demand that apparently was sharper than the fall in supply (at least in Korea and Thailand; see Ghosh and Ghosh 1999; Lane et al. 1999). In addition, there is some evidence that the allocation of bank credit improved (see Borenzstein and Lee 2000). In the end, I doubt we would have obtained a better combined score on economic activity and on bank losses if capital requirements had been less binding during 1998–2000.

Drawing on a sample of thirty-four countries (twenty-seven of them developing or transition economies) that have experienced significant fiscal costs from bank failures over the 1970–2000 period, Honohan and Klingebiel (2000) compare “regulatory forbearance” versus “strict” approaches to crisis resolution. They find that unlimited deposit guarantees, open-ended liquidity support, repeated recapitalizations, debtor bailouts, and regulatory forbearance add significantly and sizably to costs. One of their main conclusions bears repeating:

Our findings clearly tilt the balance in favor of a “strict” approach to crisis resolution, rather than an accommodating one. At the very least, they

emphasize that regulatory authorities which [sic] choose an accommodating or gradualist approach to an emerging crisis need to be sure that they have some other way of controlling risk. (19)

Fourth, compliance with the Fund's structural policy conditionality appears to have been much better than the average (for all Fund programs) in Korea and in Thailand but not so in Indonesia. A good deal of progress has been made on financial-sector rebuilding and reform, but much still remains to be done. Moreover, it is still too early to know whether the excessively close relationship between large business and government that has been the source of so much inefficiency and favoritism has changed fundamentally for the better.

It's not easy (especially for an outsider) to measure compliance with structural policy conditions because the Fund programs with the three crisis countries were revised often over the 1997–2000 period and because some structural benchmarks have been dropped or added from one revision to the next. Still, suppose we define “compliance” as having met a condition within, say, three months of the target date. Then my ballpark estimate would be that Korea has complied with about 90 percent of the structural conditions laid out in the Fund's program.⁴⁴ The corresponding compliance figure for Thailand would be about 70 percent. Two areas where compliance was weak in Thailand were reform of state banks and privatization of public enterprises. The calculation for Indonesia is subject to the largest margin of error but probably falls in the 20–40 percent range. In Indonesia, compliance with structural conditions has been seriously handicapped by prolonged political instability and by a weak approach by the government toward debtors; compliance has been lower in noncore policy areas than in core areas.

The problem with looking only at the share of structural conditions met is not only that some are more important than others: it is also that most structural policy conditions capture *processes* that do not necessarily have a tight link with outcomes. For example, if the structural benchmark says you must have two outside directors appointed to a corporate board, that can be done, but the outside appointees may not differ much from their predecessors. Or a loan can be restructured, but in a way that doesn't much reduce the present discounted value of the borrower's debt burden. For this reason, it is useful to look at some other, less process-oriented benchmarks for the financial and corporate sectors.

As background, we should recall that the three crisis countries (as a group) experienced a sharp output recovery in 1999 and 2000; inflation is mostly under control, and their current accounts are in surplus (albeit much

44. During a visit to South Korea in May 2000, I met with many Korean officials who had been involved in the crisis negotiations with the Fund. My overall impression is that most of the structural conditions included in the Fund program had been on the domestic reform agenda for a long time and thus were not viewed as “imposed” on Korea. This may explain in part why the compliance rate with structural conditions has been so high.

Table 5.8 Asian Crisis Countries: Real GDP, Consumer Prices, and Current Account Balance

| | Real GDP (annual % change) | Consumer Prices (annual % change) | Current Account Balances (as % of GDP) |
|-------------------|-------------------------------|--------------------------------------|---|
| Indonesia | | | |
| 1998 | -13.0 | 58.0 | 4.2 |
| 1999 | 0.3 | 20.8 | 3.7 |
| 2000 ^a | 4.5 | 3.3 | 6.5 |
| 2001 ^a | 4.2 | 5.6 | 5.3 |
| Korea | | | |
| 1998 | -6.7 | 7.5 | 12.8 |
| 1999 | 10.7 | 0.8 | 6.1 |
| 2000 ^a | 9.0 | 2.4 | 2.6 |
| 2001 ^a | 5.0 | 3.5 | 1.7 |
| Thailand | | | |
| 1998 | -10.2 | 8.1 | 12.7 |
| 1999 | 4.2 | 0.3 | 9.1 |
| 2000 ^a | 5.5 | 1.6 | 7.7 |
| 2001 ^a | 4.0 | 2.3 | 9.4 |

Sources: 1998 and 1999, IMF (2000); 2000 and 2001, Spencer (2000).

^aEstimated.

reduced from the huge current-account surpluses of 1998); see table 5.8. In addition, they have much lower ratios of short-term external debt to international reserves than immediately preceding the crisis; they have abandoned publicly declared exchange rate targets; and both nonperforming loans in the banking system and corporate insolvencies are retreating from their peaks. They are moving in the right direction—albeit too slowly—on banking supervision and corporate governance. Additionally, in Korea, the debt-equity ratios for most of the largest *chaebol* have declined sharply. Turning to the negative side of the ledger, equity prices have declined sharply throughout emerging Asia (with the notable exception of China); the expected growth slowdown in the United States meant that export growth of the crisis countries was likely to be much lower (by roughly half) in 2001 than it was in 2000; volatile oil prices are a source of great uncertainty; the high public debt burden in Indonesia and the large fiscal deficit in Thailand limit the scope for countercyclical fiscal policy; bank lending to the private sector has been weak outside Korea; Japan's recovery remains both anemic and fragile; and there has been some political turbulence in the region (the Philippines and Taiwan).

Table 5.9, taken from Claessens, Djankov, and Klingebiel (1999), provides a summary of financial restructuring in the three crisis countries, at least as of mid-1999. Although there have been later developments, a number of their findings merit mention.

Korea has used a combination of recapitalizations, nationalizations,

Table 5.9 Financial Restructuring in Asian Crisis Countries

| | Indonesia | Korea | Thailand |
|---|---|--|--|
| 1. Initial liquidity support to banks | \$21.7 billion (18% of GDP) 64 of 237 | \$23.3 billion (5% of GDP) None > 117 | \$24.1 billion (20% of GDP) 1 of 15 57 of 91 |
| 2. Bank shutdowns | n.a. | | |
| 3. Shutdowns of other financial institutions | 4 of 7 state banks | 11 of 26 absorbed by other banks | 3 banks and 12 finance companies |
| 4. Mergers of financial institutions | 12 | 4 | 4 |
| 5. Nationalizations | Plan in place; some bonds issued | Government injected \$8 billion into 9 commercial banks; 5 out of 6 major banks now 90% controlled by state | Plan in place; government injected \$8.9 billion into private banks and \$11.7 billion into public banks |
| 6. Public funds for recapitalizations | | | |
| 7. Majority foreign ownership of banks | Allowed, 1 potentially | Allowed, 2 completed and 1 near finalization | Allowed, 2 completed and 4 pending |
| 8. Weak financial institutions still in system | Many weak commercial banks | Many weak nonbank financial institutions | Some weak public and private commercial banks |
| 9. Nonperforming loans remaining in banks (% of total loans) | 22 | 18 | 50 |
| 10. Capital shortfall of banking system (% of banking system assets) | 18 | 4 | 8 |
| 11. Corporate governance + management of banks | | | |
| a. independent outside directors | None | 2/3 of board slots | 19 |
| b. changes in top management, majority-owned domestic banks | None | 6 of 11 major banks | 3 of 11 banks |
| 12. Corporate restructuring (August 1999) | | | |
| a. out-of-court restructured debt/total debt (%) | 13 | 40 | 22 |
| b. in-court restructured debt/total debt (%) | 4 | 8 | 7 |

(continued)

Table 5.9 (continued)

| | Indonesia | Korea | Thailand |
|---|-----------|--------|----------|
| 13. Interest difficulties of firms; percent that cannot cover interest expense from operational cash flows 2000–02 (assuming 1999 interest rates) | 53 | 17 | 22 |
| 14. Public debt (% of GDP) | | | |
| a. 1997 | 48 | 11 | 7 |
| b. 1999 | 98 | 37 | 40 |
| 15. Quality of financial-sector regulation index (4 = best practice, 1 = weakest) | | | |
| a. 1997 | 1.3 | 2.7 | 1.0 |
| b. 1999 | 2.0 | 3.0 | 2.7 |
| 16. Ownership concentration + legal framework | | | |
| a. percent ownership of top 15 families | 62 | 38 | 53 |
| b. efficiency of judicial system, index (1 = worst, 10 = best) | 2.5 | 6.0 | 3.2 |
| c. rule of law, index (1 = worst, 10 = best) | 4.0 | 5.4 | 6.3 |
| d. corruption, index (1 = worst, 10 = top) | 2.2 | 5.3 | 5.2 |
| 17. Market structure changes in financial sector | | | |
| a. number of commercial banks: taken over/sold to foreigners/nationalized | 4/0/12 | 5/2/4 | 0/2/4 |
| b. number of private domestic banks: market share (%) | 122(21) | 18(37) | 13(48) |
| c. number of state banks: market share (%) | 43(78) | 10(58) | 6(45) |
| d. number of nonbanks: market share (%) | 245(1) | 11(5) | 22(7) |

Source: Claessens, Djankov, and Klingebiel (1999).

Note: In a more recent World Bank [2000] report, it is estimated that nonperforming loans, as of June 2000, account for 30, 10, and 30 percent of total loans in Indonesia, Korea, and Thailand, respectively.

removal of bad debt, and mergers to strengthen its banking system.⁴⁵ However, it was much less active against weak nonbanks and has had to clean up a mess with those investment trusts that rushed in to finance the *chaebol* (especially Daewoo) after the banks cut back. Thailand has closed about two-thirds of its finance companies but has gone more slowly on bank restructuring, asking the banks to raise their own capital and making public money subject to stricter prudential and management changes. Indonesia, after a large, initial liquidity injection to banks, has gotten less far on bank restructuring than the others.

Banks are still undercapitalized—moderately in Korea, more so in Thailand, and extremely so in Indonesia. Nonperforming loans are still very high in Thailand and Indonesia. Korean banks may be able to cover their capital shortfalls from earnings; this is not so with either Thai or Indonesian banks. Korea and Thailand have made some governance and management changes in their banks, Indonesian banks much less so.

Korea and Thailand have restructured about one-half and one-third, respectively, of corporate debt, the bulk of it in out-of-court settlement; the corresponding figure for Indonesia is roughly one-sixth. Although corporations have benefited from the recovery, about one-quarter of Thai firms and over half of Indonesian ones cannot meet interest payments out of operational cash flows.

Despite quite significant increases in foreign direct investment, all three Asian economies have seen their public debt rise appreciably as a result of financial restructuring costs. Public debt is about equal to gross domestic product (GDP) in Indonesia and is more than one-third of it in both Korea and Thailand (having risen from very low precrisis ratios).

Gains have been made in the quality of financial regulation, but it still trails best international practice. So far, Korea and Thailand have come farther than Indonesia on this score. Corporate ownership is still very concentrated among the top fifteen families in all three countries. Corporate governance is changing, but a weak judicial system in Indonesia and a poor bankruptcy law in Thailand have limited the advances.⁴⁶

Last but not least, because of heavy government intervention into the financial system during the crisis (nationalizations, purchase of bad assets, etc.) the government now owns a huge share—about 50 percent on average for the three countries—of total banking assets. Because governments do not do well owning and managing banks, there is a strong need for much larger divestitures (including sales to foreigners) than have occurred to date.⁴⁷

45. In late September 2000, the Korean Government announced that it would be putting in an additional \$44 billion of public funds to deal with bad loans of the banking system.

46. Other analysts (e.g., Root [2000] and Spencer [2000]) have pointed to the low number of affiliate sales by the *chaebol* and the recent rescue of Hyundai Engineering and Construction as disappointments in the Korean reform effort.

47. See Root (2000) on why a more decentralized approach to financial restructuring in Korea would yield better results than a government-dominated strategy.

To sum up, studies of the effects of Fund programs show that they have positive effects on the current account and overall balance of payments; effects on growth, inflation, and income distribution have proved to be much harder to pin down with any precision. Those transition economies that have done more on implementing Fund structural performance criteria appear to have done better on economic growth and structural policy reform more generally than those with weaker compliance records. Those emerging economies with better corporate governance structures in place prior to the outbreak of Asian crisis were, on average, hit less hard with currency and stock market declines during the crisis than those with a poorer track record on corporate governance. For the most part, Fund structural policy recommendations reflect the economics profession's consensus of what constitutes sensible structural policy reform, although some serious mistakes on the sequencing of reforms have sometimes taken place. The core of the Fund's structural policy conditionality in the three Asian crisis countries—which focused mainly on financial-sector crisis management and restructuring—was appropriate, with the exception of the bad compromise made on bank closures in Indonesia. That said, the Fund's structural conditionality in the Asian crisis countries (and especially in Indonesia) appears excessive—both in scope and in detail. Thus far, compliance with that conditionality has been high in Korea, above average in Thailand, and below average in Indonesia. Looking at a broader array of indicators, progress on restructuring in East Asia is evident but much more needs to be done to put banks and corporates on a sound footing. It is too early to tell whether the past close relationship between government and business has changed fundamentally for the better.

5.1.4 How Did Fund Structural Policy Conditionality Get to be This Way?

If one concludes that Fund structural policy conditionality has become more intrusive than necessary, it is relevant to speculate on how it might have gotten that way. In my view, nine factors have contributed to that trend.⁴⁸

First, in the 1970s and early 1980s, IMF programs came under sharp criticism from many developing countries as being too demand-oriented and too short-run and as not paying enough attention to economic growth, to supply-side reforms, and to income distribution. The disappointing growth performance of developing countries in the early 1980s added to those concerns. Because developing countries increasingly constituted the demand for Fund resources, neither the Fund nor creditor governments could easily dismiss that criticism. New lending windows with higher structural policy content and with lending terms more favorable to low-income countries were created, and monitoring techniques for gauging compliance with structural policy conditions evolved.

48. Several of these factors are discussed in Allen (1993).

Second, the expansion of the IMF's surveillance responsibilities—agreed upon in the mid-1970s under the second amendment of the Fund's charter and given expression in the revised Article IV—permitted Fund Article IV country missions to take a wider field of view in evaluating economic developments and prospects. Structural problems thus came under greater scrutiny. This greater familiarity with structural problems may in turn have led to a greater readiness to include structural policy conditions in programs, at least in those cases in which structural weaknesses were perceived, rightly or wrongly, to have been linked to crisis vulnerability.

Third, the huge transformation task faced by the transition economies—especially in the first half of the 1990s—made structural policies and the building of a market infrastructure the name of the game in that region. And the IMF (along with the European Bank for Reconstruction and Development) was at the center of the technical assistance and policy lending to those transition economies. Again, structural benchmarks came to be relied upon as a way of monitoring structural policy conditionality across a wide front. When structural problems arose in later crises (such as that in Asia), the same monitoring techniques were applied.

Fourth, all the while, the Fund was more and more interpreting its mandate as broader than just promoting macroeconomic and financial stability and helping countries to manage financial crises. From the mid-1980s on, economic growth and, later, high-quality growth were given increased prominence. After the Mexican peso crisis of 1994–95, crisis prevention—with particular attention to strengthening financial systems at the national level and developing international standards and codes of good practice—too moved up on the agenda.

Fifth, crises that involve severe balance sheet problems of banks and private corporations lead to more structural policy intensive fund programs than do those that stem from traditional monetary and fiscal policy excesses—and the Asian crises of 1997–98 had those balance sheet problems in spades. The IMF's executive board also seems to have sent staff the message (in 1997) that lending into serious governance and corruption problems (without any measures to address them) would not receive board support. In the Indonesian program, a decision was made to try to impress the markets with the comprehensiveness of the reform effort.

Sixth, the long-standing and growing problem of obtaining good compliance with Fund programs led over time to greater reliance on prior actions and to more wide-ranging and detailed structural policy conditions, presumably in an effort to penalize poor earlier track records, to thwart evasion, and to detect slippage at an earlier stage.⁴⁹ If this broader and more detailed conditionality didn't produce higher compliance and the amount of

49. Failure to implement earlier Fund recommendations can over time push up structural conditionality even when some of those recommendations come in the form of technical assistance rather than as conditions in Fund programs.

structural reform hoped for, maybe the Fund concluded that it was still inducing more structural reform than would obtain with lesser Fund structural policy conditionality. The Fund's Guidelines for Conditionality—which might have reined in excessive structural policy conditionality—came to be viewed by the Fund's executive board as broad principles of intention, not as something to be monitored carefully and enforced.

Seventh, in the meantime, a wide array of legislative groups, nongovernmental organizations (NGOs), and even other international financial organizations came to see an IMF letter of intent as the preferred instrument of leverage for their own agendas in emerging economies. Yes, the International Labor Organization (ILO) might be the logical place to push core labor standards, but it doesn't have the teeth of an IMF program. Simultaneously, various G7 governments—and particularly the Fund's largest shareholder—were finding it increasingly difficult to get congressional support for “clean” IMF funding bills. Reflecting this congressional pressure from both major parties, the U.S. executive director at the Fund has been obliged to support with voice and vote a long list of structural policies (ranging from protection of the environment to promotion of economic deregulation and privatizing of industry), and the U.S. Treasury (2000a) is required to report annually to Congress on its compliance with relevant sections of the Foreign Operations, Export Financing, and Related Programs Appropriation Act of 1999. A reading of that report (U.S. Treasury 2000a) confirms that the United States frequently pushed for policies in fund programs that were far from the Fund's core competence. Likewise, in countries where there was prolonged use of Fund resources, IMF letters of intent sometimes became an instrument of leverage that the finance ministry could use in order to push structural reforms on other departments in the government that were opposed. In short, everybody has gotten in on the act.

Eighth, unlike other IFIs, the Fund and the World Bank have sufficient “ground troops” to make on-site visits to all countries. In addition, at least in official circles, the Fund has developed a reputation as being able to act quickly and efficiently. When new structural challenges have arisen, there has therefore been a tendency to say, “give it to the Fund; they go there anyway; have them just add a few specialists on problem x to the mission.” The management of the Fund has apparently not said “no” very often to those demands.

Finally, there have been occasions—the Korean and Indonesian programs are important cases in point—when strong pressure from particular G7 governments (during program negotiations) resulted in the inclusion of specific structural policies in a Fund program, and this despite the provision in the Fund's charter (IMF 1988, 42, Article XII, section IV) for each member country of the Fund to “refrain from all attempts to influence any of the [Fund] staff in the discharge of [their] functions.”

5.1.5 Approaches to Streamlining Fund Structural Policy Conditionality

The Fund's new managing director, Horst Kohler, has already indicated that he thinks that the Fund "has been overstretched in the past and needs to refocus" (Kohler 2000c, 3); he has also flagged his intention to end "mission creep," in large part by streamlining structural policy conditionality. To carry out that objective, there are at least eight approaches (not all of them mutually exclusive) worth mentioning.

Structural Preconditions

This radical approach, favored by the majority of the Meltzer Commission (see IFIAC 2000), would jettison *ex post* IMF conditionality in favor of a small number of preconditions, namely, freedom of entry and operation for foreign financial institutions, regular and timely publication of the maturity structure of outstanding sovereign and guaranteed debt and off-balance sheet liabilities, adequate capitalization of commercial banks, and a proper fiscal requirement.⁵⁰ Developing countries that met these preconditions would be eligible immediately for short-term liquidity assistance; those developing countries that did not meet them would not be eligible.

Objections to this approach have been registered on three counts (see Bergsten et al. 2000).

Although meeting these preconditions would reduce the risk of getting into a crisis, they would hardly be sufficient for crisis prevention. Although many currency and debt crises begin in the banking sector, quite a few others do not, and freedom of entry plus a capital requirement are not good substitutes for the broader range of measures outlined in the Basel Core Principles of Effective Banking Supervision.⁵¹ The fiscal policy precondition is not defined in the report, and making it operational would be subject to the same kind of negotiation and intrusiveness as with present Fund conditionality.

More fundamentally, even if satisfied, these preconditions would not get a country out of a balance-of-payments crisis once it got into one. Without measures to reduce absorption and to switch expenditure from foreign to domestic goods, the crisis country's ability to repay would not improve. Moreover, giving large Fund loans to a country with a runaway inflation or a huge budget deficit would increase moral hazard, not reduce it.

Last but not least, it is highly questionable whether the international community would be willing to exclude completely from IMF financing countries that didn't meet these preconditions, particularly when a new gov-

50. At present, the only Fund lending window that uses prequalification is the Contingency Credit Line (CCL). However, since its inception in 1999, no country has yet come forward to use it.

51. Garber (2000) has argued that a subordinated debt requirement for banks à la the Meltzer Report could easily be manipulated and evaded.

ernment promised policies different from its predecessor.⁵² For this reason, the Council on Foreign Relations Task Force (1999) rejected the “all-or-nothing” approach and opted instead to penalize (reward) countries that have followed poor (good) policies by charging them higher (lower) interest rates when they needed to borrow from the Fund.

Collateralized Fund Lending

Another radical approach to reducing or eliminating Fund structural policy conditionality would have the fund follow the Bagehot (1873) guideline and lend on good collateral (see Meltzer 1999; Feldstein 1999). Good collateral is meant to serve several purposes. It provides a test of whether the borrower is just illiquid rather than insolvent (a solvent borrower has good collateral to pledge; an insolvent one does not); it safeguards the solvency of the lender; and it reduces (borrower) moral hazard by discouraging the borrower from holding risky assets that would not be accepted as good collateral.

Opposition to the collateral proposal emanates from several arguments. If eligible collateral is defined narrowly and strictly (say, holdings of U.S. government securities), then it will not provide much additional advantage in crisis management (since countries so endowed wouldn’t need to come to the Fund—they could borrow from private markets). Pledging collateral to the Fund might also run afoul of “negative pledge” clauses in existing loan agreements, and even if it didn’t, its favorable impact would be limited because it would raise borrowing costs on the noncollateralized debt. Some would contend too that liquidating the collateral (say, export receipts) in the event of repayment problems (stemming either from bad luck or poor policy performance) would subject the Fund to even harsher criticism from developing-country borrowers than it receives when it interrupts disbursement under a Fund program. Would the United States, for example, have been able politically to cash in the collateral (oil receipts) pledged by Mexico during the 1994–95 peso crisis if things had not worked out so well for Mexico in 1995?

Define Conditionality in Terms of Outcomes, Not Structural Policies or Benchmarks

The idea here would be for the Fund to leave the *process* by which countries respond to crises up to them and instead condition Fund assistance on positive changes in certain outcomes. For example, instead of making changes in the judicial system or the establishment of a new framework for

52. See Polak (1991). U.S. Treasury (2000b) argues that these preconditions would have precluded the IMF from responding to financial emergencies in the vast majority of its member countries, including all the Asian crisis countries.

corporate debt restructuring conditions of the program for Indonesia, the Fund could just say that half of the nonperforming corporate debt has to be rescheduled by date *x*. If the country meets the target, it gets the money; otherwise, it doesn't.

The rub here is that performance criteria are normally confined to variables that are under the control of the borrower. The difficulty with defining structural conditionality in terms of outcomes is that exogenous developments could affect the borrower's ability to meet the target. Consequently, there would be many demands for waivers. In addition, outcomes are often not easy to define for some structural policies (e.g., what is "good" banking supervision, or what constitutes a "restructured" loan). Finally, one of the main purposes of the Fund is to rule certain crisis management processes (e.g., increased resort to trade restrictions) as out of bounds.

Put Restrictions or Penalties on Foreign-Currency Borrowing

If much of structural policy conditionality comes from balance sheet problems of banks and corporates and the latter, in turn, often derive from the buildup of large currency mismatches, why not attack the problem at its source by seeking to discourage foreign-currency borrowing (see Krueger 2000; Dooley 1999)? Presumably, a key reason why Brazil has had a much milder crisis than the Asian countries is that currency mismatching in Brazil was better controlled; hence, when the real crashed, there were many fewer banking and corporate insolvencies. Although (enlightened) government borrowers ought to be able to internalize these externalities, this is not so for private borrowers, who may expect either a government bailout (if things go badly) or who may be driven to take up the cheaper foreign-currency loan because competitors are doing it. Although timely publication of aggregate data on currency and maturity mismatching may improve market discipline, some have proposed going much farther. Krueger, for example, has suggested that foreign-currency obligations incurred by domestic residents of emerging economies be made unenforceable in domestic courts. Others have argued that the currency mismatching problem is a powerful argument in favor of dollarization.

One counterargument is that such measures are too drastic for the problem at hand. If currency mismatching is the problem, why not have the government develop better hedging mechanisms (e.g., futures exchanges), as Mexico has been doing since it moved to a floating rate? Others might say that giving up (via dollarization) the potential advantage of access to easy monetary policy during a severe recession just to minimize the risk of one particular type of crisis is allowing the tail to wag the dog. Enforcement of currency-matching restrictions could also be a problem. In today's world of structured derivatives, what looks like a domestic-currency loan could well have embedded options that amount to an unhedged bet on the exchange rate.

Greater Resort to International Standards

Instead of custom-tailoring structural conditions to a particular crisis situation or particular financial institutions, the fund and its member countries could rely more on generic international standards. For example, if there was a serious problem with data disclosure, or with banking supervision, or with corporate governance, the crisis country could agree to meet international standards in these areas by date x . A potential appeal of the standards is that they represent the consensus on good practice in that area by a group of international experts—not the views of an individual mission chief or even of the Fund (see Eichengreen 2000). Since the fund is already engaged (on a voluntary basis) in evaluating countries' compliance with standards and codes, this approach might also afford more flexibility in the time frame for meeting these conditions.

The disadvantage of the standards approach is that the standards themselves may not be specific enough to address the pressing problems at hand. If the elements of the standards are too vague, monitoring would likely lead to frequent disagreements.

Leaner Structural Conditionality within Present Arrangements

Under this approach, the Fund's executive board would issue a new guidance note calling for "leaner" structural conditionality; henceforth, each structural condition included in a program would have to be directly related to financial stability and would have to carry a macroeconomic impact; in addition, the note might increase the use of formal performance criteria relative to more discretionary structural benchmarks and program reviews. The aim of this new guidance note would be not only to induce mission chiefs to be less wide-ranging and detailed in their structural policy recommendations but also to dissuade *both* creditor and debtor governments from pushing for structural conditions that did not fall within the Fund's core competence ("I'd like to help you, Mr. Deputy Minister, but that just isn't our job"). Associated with this leaner structural conditionality might also be an effort to increase the Fund's leverage for structural policy reform in nonprogram channels. For example, structural weaknesses could be given more attention in published Fund Article IV reports, leaving it more to the private markets to apply pressure for reform. Additionally, much of what now appears as detailed structural benchmarks (in a Fund program) on how to implement a given structural reform could be handled in Fund technical assistance.

Skeptics might argue that the existing guidance note on conditionality that has been around for twenty years or more is perfectly adequate. Why would a new one make much of a difference? To make a difference, management and the Fund's executive board would have to be much more committed to enforcing the new note than they were in enforcing the previous

one. However, this would be unlikely to happen unless there was a clear understanding with the G7 and with emerging economies that greater restraint would be exercised than heretofore in assigning the fund new tasks. For example, just within the few months previous to the time of this writing, the G7 requested the IMF to step up its monitoring of money laundering. Questions would also arise on how many structural conditions and how much detail would be appropriate for such a leaner structural conditionality (that is, would it be a big change from prevailing practice, or only a small modification?).

Allowing the Fund to Borrow in the Private Capital Markets

If some G7 legislatures use the Fund's requests for funding (increases in quota, funding for new facilities and debt initiatives, etc.) as points of leverage to impose a variety of (counterproductive and superfluous) conditions on Fund lending practices, it might be argued that the Fund should be given authority to borrow in the private capital markets (thereby increasing its independence).⁵³ Those who oppose this proposal would contend that the Fund itself, not G7 legislatures, is the main source of excessive structural conditionality; thus, easier funding would reduce "accountability" to the Fund's shareholders and might just as well increase the scope of Fund conditionality as reduce it.

Clearer Division of Responsibility with the World Bank and More Outsourcing of Structural Conditionality in Noncore Areas

The aim here is to retain the advantages of a "comprehensive" approach to crisis prevention and management, sustainable growth, and poverty reduction, while improving the effectiveness of (total) structural policy conditionality by paying greater attention to the different comparative advantages of the various IFIs. Even if the number of structural conditions in Fund programs remained unchanged, the Fund would design and monitor only those conditions that fit within its defined "core competence" (say, monetary, fiscal, exchange rate, and financial-sector policies); anything else would be the responsibility of the World Bank or other IFIs. If one of the other IFIs was not moving fast enough in drafting a structural policy requirement, the Fund would not be permitted to take over. It would have to stay in its own yard. Under some proposals, the Fund would transfer primary responsibility for running the Poverty Reduction and Growth Facility (PRGF) to the World Bank, although the Fund would still have a sign-off on the adequacy of macroeconomic policies in such programs with low-income countries. Under other proposals (see Kohler and Wolfensohn

53. Another proposal for reducing political demands on the Fund is go to "independent" executive directors—much in the manner of national central banks; see De Gregorio et al. (1999).

2000), the World Bank would get its own new lending window (the Poverty Reduction Support Credit [PRSC]) to support poverty reduction in low-income countries, and the Fund would continue to run and fund the PGRF. Renewed efforts would also be made to improve Fund-World Bank cooperation.

Here, too, there are many potential objections and questions. If the problem is too much and too detailed structural policy conditionality as a whole, why would rearranging responsibilities among the IFIs solve it? If the PGRF is about poverty reduction and if that is supposed to be the main focus of the World Bank, why does the Fund run that facility? If it's true, as suggested by the U.S. Treasury (2000a), that unless the Fund's board has its own money at stake, Fund evaluation of macroeconomic policies in programs with low-income countries won't be done seriously (even with a formal sign-off in programs run by the World Bank), why should we expect other IFIs to be diligent in their evaluation of structural policies in Fund-led programs? Why do we need *two* lending facilities (the existing PGRF in the Fund, and the new PRSC in the World Bank) to support poverty reduction and macroeconomic stability in the low-income countries? Wouldn't one make more sense? How will the IMF and World Bank cooperate more closely with other international organizations (e.g., the Organization for Economic Cooperation and Development, the Bank for International Settlements, the World Trade Organization, the ILO, etc.) under the "contracting-out model" and still meet the demanding time requirements of crisis resolution?

5.1.6 Concluding Remarks

I agree with Stanley Fischer's (2000a, 2) assessment that "the IMF. . . promotes good macroeconomic and financial-sector policies among its members." However, my reading of the record is that on structural policies the Fund has bitten off more—in both scope and detail—than either it or its member countries can chew. There are limits—no matter how numerous and detailed the Fund's monitoring techniques—to how far the Fund can push a country to undertake structural reforms that it itself is not strongly committed to. Consistent with this view, compliance with fund conditionality has been a serious and growing problem. International Monetary Fund mission chiefs have considerable knowledge and experience in macroeconomic and financial policies but not in structural policy areas beyond this core competence. Efforts to include in Fund conditionality everything but the kitchen sink under the loosely defined agenda of pursuing "high-quality" growth have taken the Fund too far from its comparative advantage and have elicited legitimate charges of mission creep.

Among the alternative crisis management guidelines discussed in section 5.1.2, the one (Mandate II) that would have the Fund focus on macroeco-

nomie and financial stability and assist a country not only to get out of its current crisis but also to minimize the chances of getting into another one makes the most sense to me. Conditions that lie outside the core areas of monetary, fiscal, exchange rate, and financial-sector policies should be significantly fewer in Fund programs than the average of the past five years and should require strong justification in any program, including having a macroeconomic impact (as called for in the original conditionality guidelines for standby programs). I also read the record as suggesting that the effectiveness of Fund structural conditionality would be increased if a small number of structural performance criteria was substituted for the vast array of structural benchmarks that have characterized many past Fund programs. This would require IMF staff to think harder about which structural conditions merited the highest priority in the reform effort, and about which structural policy changes needed to be made now (during the crisis) and which could wait until somewhat later; putting more weight on a few structural performance criteria would also send a clearer signal to the borrower that failure to meet those performance criteria would likely result in a halt in Fund disbursements.

Last but not least, streamlining and improving Fund structural policy conditionality is about Fund management saying “no” more often than in the past—to requests for Fund assistance where the expectation is low that the country will actually implement Fund policy conditions, to G7 governments when they propose new tasks for the Fund that go beyond the Fund’s core competence, to NGOs that seek to use a country’s Letter of Intent with the Fund to advance agendas (even if desirable) that lie outside the Fund’s mandate and comparative advantage, and to developing-country finance ministries that want to use micro conditions in Fund programs to impose spending discipline on other government ministries that could not be obtained via their national legislatures.

Mr. Kohler’s intention to end mission creep at the Fund and to streamline the Fund’s structural policy conditionality is welcome. However, it remains to be seen how he will pursue that objective and what the effects will be.

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2. Timothy F. Geithner

Structural Conditionality in IMF Programs

This is a good time for a broad reassessment of the appropriate scope of International Monetary Fund (IMF) conditionality.

The new conventional wisdom, fathered in part by Martin Feldstein, the thrust of which is that the fund has strayed far beyond its classic mandate to the point that it is gratuitously intrusive in a ridiculously expansive array of micro-level structural issues, is debilitating in its impact on the Fund's credibility. When the popular perceptions of the world's preeminent monetary institution are so dominated by small anecdotes of contestable judgments about cashews, sugar, cotton, or cloves, then you have a real problem,

even if the judgments made were in fact fundamentally sensible. It is not a good sign when the debate about the Fund is framed by criticisms that echo the critique of U.S. diplomacy as foreign policy as social work or misguided nation building.

So this is a necessary debate, and, like the recent debate about facilities reform and pricing, it's a good way to reevaluate the basic mission of the institution.

Figuring out what to do about this potential problem of overreach is not easy, however. It is complicated by a few basic features of the present reality.

There is the basic reality that world has come over time to adopt a rather expansive definition of the range of policies and institutions that are important to economic success, to durable development, to reducing vulnerability to crises. The analytical judgments that led the Fund to conclude some time ago that there was a set of structural policies beyond the classic core of the monetary policy framework, the fiscal constraint, and the exchange rate regime that were in many cases necessary for successful programs remain valid today.

There is the basic reality that a cooperative institution structured like the Fund does not really have the luxury of not lending to its members, provided they are willing to promise to commit to some conditions. Moreover, in an institution of 182 members, many of which are what you might call weak states, governance challenged, and the like, a basic level of prudence or fiduciary responsibility will necessarily require broad, and sometimes intrusive, safeguards on how the resources of the Fund are used.

There is the basic reality that it will be untenable for the Fund to put substantial resources at risk in any country without seeking to address the problems that materially contributed to the crisis and without trying to reduce the sources of vulnerability to future crisis. If the Fund is denied this capacity, then you won't have a Fund with a meaningful capacity to intervene in crises.

There is the basic reality that the Fund does not have the capacity to apply meaningful conditionality *ex ante*, and thus much of the burden for important reforms falls on program conditionality *ex post*.

Finally, there is the basic political reality, most conspicuous in the United States, and fueled in part by the globalization anxiety, that has tended to support a progressively more expansive view of what the Fund should seek to achieve in terms of social equity, much less economic efficiency, using the leverage of its programs.

There is a fundamental danger in the new conventional critique of the Fund that its adherents shelter a diverse mix of motivations.

Some of the proponents of a return to some set of narrow, core, simple, old virtues of macroeconomic probity are moved primarily by opposition

to or discomfort with the notion of conditionality itself. A simple requirement for collateral seems an appealing alternative to many.

Some of the critics are in the “ownership camp,” which in its more extreme form has the strange circular logic that effective conditionality is possible only where it is fully owned, and where it is fully owned it is essentially unnecessary, and it is pushing the international financial institutions (IFIs) generally in directions that may produce simply less conditionality or weaker conditionality.

Some of the proponents of streamlining are moved by one critique of the Fund’s prescriptions in Asia, a critique based on a not totally implausible view that the crisis was a liquidity crisis suffered by fundamentally quite healthy economies and that therefore recovery should not have required significant policy change. The truth, however, is that fundamentally healthy countries are not really vulnerable to sustained panics or runs that threaten a deeper crisis. Moreover, the countries in Asia each had a set of fundamental weaknesses that left them vulnerable to shifts in sentiment, and addressing those weaknesses was plausibly considered critical to a restoration of confidence and more durable recovery.

Some of the proponents of streamlining see a compelling virtue in simplicity for simplicity’s sake, with the somewhat naive hope that the Fund can stay out of complex choices that are inescapable in dealing, for example, with a systemically insolvent financial system, where the government owns not just the banking system but much of the corporate assets of the country, and where there is no functioning legal system or other safeguards to prevent looting, or with a fiscal problem in a poor country where scarce resources are drained by state enterprises or subsidies for the urban class, or with an adjustment challenge in a country with a currency board where the structure of the labor market does not allow wages to adjust.

These motivations are not, I think, good reasons to favor streamlining, and they are not a good guide for how to refocus the Fund. To indulge them is in some respects dangerous, if you care about preserving the capacity of the fund to be engaged in creating a world less vulnerable to financial crisis, in promoting more durable transition in emerging market economies to capital-market access, and in addressing the development challenges in the poorest countries.

What is the right standard for determining what the Fund should and should not promote in its programs? There are three such approaches that I do not think make sense. The core/noncore distinction doesn’t answer the question of what should be core. The critical/noncritical distinction doesn’t help define what should be critical. The less-is-more minimalism doesn’t define what minimalist core would actually be more effective than the broader alternatives.

The challenge is to define an affirmative standard for deciding what is im-

portant: core, critical, and so on. One way to do that is to think of a continuum, with the classic core macroeconomic framework at one extreme, with the financial system next, then other conditions necessary to restore confidence and capital market access and reduce the risk of future crisis, then governance issues, and then at the other end of the continuum a broader set of policies that are desirable from the standpoint of economic efficiency and social equity.

On this continuum, I think the right place for the Fund to start in the crisis context is in that middle area, with the presumption that, in addition to the macroeconomic policy framework and the financial system, you have to try to address credibly those other factors that are critical to restoring confidence and growth, to restoring capital-market access as soon as possible, and to reducing the risk of a future crisis. Moreover, it should be symmetrically hard to move too far in either direction on that continuum, either to the fundamentally more narrow extreme or to the more expansive realm of the simply desirable improvements in economic efficiency.

Under this standard, it would be appropriate to seek in the program to address, where they are material, fundamental problems in the insolvency regime, protections for minority shareholders, restrictions on capital inflows, and distortions in the capital account regime, the deposit insurance system, the social safety net, the legal regime governing privatization and asset disposal, conspicuous corruption problems.

This test, however, is still quite broad, and probably still too vulnerable to expansive interpretation. In order for it to work, it has to be supplemented by a set of other tests or filters to ensure a more selective approach.

- Forcing fewer conditions will help, because that will force prioritization, and sensible constraints on the quantity of measures can be effective discipline.
- There needs to be some credible test of scale and materiality in terms of economic impact.
- The Fund has to be prepared to forswear advocacy of the simply desirable, where it is not essential, or where the community of experts might disagree on the superiority of the proposed prescription.
- The Fund should be careful to agree to incorporate as a condition of the program policy requirements that do not meet the test of material or essentiality, simply because the reformers in the government want some leverage in promoting part of their broader agenda.
- It will be appropriate for the Fund to defer to the preferences of the government, if it has a record of credibility and competence and is democratically elected.
- Establishing a greater presumption against extensive structural benchmarks, and a presumption in favor of making core structural condi-

tions performance criteria, will also provide useful discipline in deciding what is really necessary to justify disbursement and worth suspending the program over if there is a failure to comply.

To support some evolution toward streamlining, I think there needs to be a complementary evolution towards a broader list of generalized conditions for access to IMF resources.

There is no reason why all IMF members should not be required to meet minimum standards for disclosure and for transparency of the fiscal accounts and monetary policy operation, to apply minimum safeguards such as the new requirement that central banks undertake annually and publish an external audit, and perhaps to meet some minimum standards relevant to the vulnerability of the financial system.

Adopting these as universal conditions will reduce the need for uncomfortably extensive lists of individualized conditions in specific programs. Shifting the burden of conditionality to disciplines that can be applied *ex ante* reduces the need for the *ex post* application of those conditions in program design.

In an institution where membership brings with it access to potentially large amounts of resources, it makes sense to have a greater set of *ex ante* constraints on potentially risky behavior. The Article IV process will never have sufficient traction to achieve this.

The corollary of this point is that we have to give the Fund the will to say “no” more often, to refuse to lend, or to suspend disbursements, in conditions that are untenable or in which justifying a program requires an excessive level of protections and therefore conditions.

It is hard to make this credible, in part because there will be cases in which the Fund will have no choice given the risk of broader economic damage to other economies. Also, it requires a greater willingness by the preferred creditors to accept the accumulation of arrears in situations in which the country at issue has large and immediate obligations to the IFIs that they may not have the resources available to meet.

Despite these difficulties, it is worth raising the bar for IMF engagement in conditions in which the level of corruption is truly systemic, the state is too weak to make credible commitments to deliver on the program conditions, governance problems are fundamental, the government is among the most extreme offenders on the money laundering or financial crime scale, and the government cannot make credible commitments in the program to address these problems.

A necessary condition for any meaningful withdrawal for the Fund from important structural conditions is a greater demonstrated capacity by the World Bank to design and apply meaningful conditionality for its program lending. This condition does not now exist. It may be in prospect, but the

pressures now on the World Bank to reduce the scope and extent of conditionality, particularly on the middle-income countries, are formidable.

This is important, because part of the cause of the perceived expansion in the scope of IMF imposed structural conditions is a pragmatic conspiracy between World Bank and IMF staff and the reformers in borrowing governments to build conditions into Fund programs because of the absence of an effective vehicle in the World Bank for applying that conditionality with force.

It is important in this exploration of ways to streamline conditionality that we not lose sight of the probably more important substantive challenge of figuring out how to improve the design of policies and the content of whatever conditionality we decide is essential. The lack of consensus in the economic profession about the appropriate macro policy response to a confidence crisis in an economy with a healthy fiscal position but a terribly weak banking sector is fundamentally troubling. The extent of debate within the Fund, between the Fund and the World Bank, and among the experts in the supervisory community about the appropriate degree of forbearance and about strategies for intervention, recapitalization, resolution, and asset disposal in banking systems undergoing systemic failure is highly problematic and caused very damaging delays in the recent cases.

These problems of the substance of the economic strategy are in some ways more material and more important to try to resolve than the perceived imperative to simply streamline.

Moreover, any credible support by the United States for progress on this front will require an effort by the next administration to buy some room for maneuvering from Congress. The erosion of the traditional internationalist center in the U.S. political spectrum has left us more vulnerable to the demands of a coalition on the right and left, the price of whose support has been an escalating set of demands, on the one hand for market-oriented reforms and liberalization and on the other hand for social equity and core labor standards. The consensus shared by Congressman Barney Frank and Senator Phil Gramm requires us to advocate a particularly broad definition of desirable or core conditionality. It's possible they may each be more willing to cede ground in favor of a more narrow mandate overall.

Finally, I think it is important to ask ourselves whether the errors of the past have fundamentally been errors of excessive ambition for policy change or excessive indulgence of poor performance. The world is still a bit confused and divided on this point. Has the Fund been too tough or too accommodating? Or, as some have suggested, has it been both, by setting unrealistic aspirations for policy reform and then acquiescing to the inevitable failure of even relatively well intentioned governments to meet the bar? There is something to this. The right approach is some mix of greater realism in the initial level of conditionality established and greater force and will in holding governments to that more realistic standard.

3. Paul Keating

Morris Goldstein's paper is of such good quality that it is important to examine it, especially given his position as a former insider, somebody who is able to stand off and look at the International Monetary Fund. As you would expect from someone of Goldstein's experience, the paper is balanced, insightful, and knowledgeable. It is practically oriented, and above all else, it's important. This is the view of somebody who does know the Fund and has the objectivity of looking at it under stress.

From my point of view the great problem, apart from what the structural conditionality and the size of the program did to the Suharto regime and to other regimes during the crisis, was first and foremost the distractions these programs presented to the task at hand. In his paper, Goldstein distinguishes crisis management from crisis prevention, suggesting that crisis management should be the guide to the program. He says, "It doesn't preclude giving some consideration to other objectives, but it makes clear which objective is king, and where the authorities' central responsibility lies. The emphasis on getting out of the current crisis would mean that crisis management and resolution and not crisis prevention should guide program design. Crisis prevention measures would then presumably be handled by countries on their own, after the crisis is resolved."

He is attempting to address the Washington consensus on financial and structural improvement, which every finance minister and every finance ministry official worth his salt knows about: decent structural reform. However, what is the relevance of structural reforms of this nature in a crisis of this kind? Goldstein says, "The number of structural policy conditions included in these programs with the three Asian crisis economies was very large, if not totally unprecedented, many more than you can count using all your fingers and toes. At their peak there were 140 in Indonesia, over 90 in Korea, and over 70 in Thailand." Then he amplifies in table 5.5 a point I made yesterday, that in October 1997, when the crisis was really starting to boil, there were 28 structural policy conditions in Indonesia. By January 1998 there were 31, and by April 1998 there were 140. Even though Indonesia was in great trouble through this period, as the rupiah really started to collapse and as political strife started to set in, the conditionality went up. In other words, not only could the athlete not get over the bar at a certain height, but the bar, instead of being lowered to give him a chance to clear it, was actually raised. The tables make this point graphically. Goldstein, thanks to Stanley Fischer, who has given him access to the IMF, has listed the remedial programs, things like reducing tariffs on nonfood agricultural products by 5 percent and gradually reducing tariffs on nonagricultural products to a maximum of 10 percentage points. Well, these are all the

things that I and people like me, in this room, hammered away at in the 1980s. We know how hard they are to do. They are important. But in a crisis like this, reducing tariffs by 5 percent on chemical products? Abolishing import restrictions on new and used ships? Phasing out remaining quantitative importing restrictions on other nontariff barriers? The list goes on. “Remove restrictions on foreign investments in palm oil plantations.” “Release farmers from forced planting of sugar cane.” It was these things and the breadth of the demands that, I believe, forced Suharto to give up and appoint his own cabinet, which included his own daughter and a number of the cronies. Of course, when that happened he put the wagons in a circle and decided to carry on independently. I do not mock these reforms—they are important in their own way—but I go back to Goldstein’s point. The imperative issue was crisis management, not crisis prevention. These are crisis prevention issues: in fact, they are not even that. They’re simply reforms that make an economy more open, more supple, and more productive. They’re matters to attend to over time, that take time, that require dealing with the special interest groups. It takes a long time to achieve these things. In Australia’s case, it took fifteen years to do these sorts of things. To demand these reforms instantaneously, in a crisis, is naive at best and wilful at worst.

Goldstein, in a very important note, says, “similarly, to show that cronyism and corruption would henceforth be less prevalent, it is important at least in Indonesia to take a few visible privileges and sweetheart deals away from those close to President Suharto.” Well, the problem, for instance, with the bank closures in 1997, when the fund shut in one of the banks that belonged to Suharto’s son, wasn’t that the bank belonged to his son; it was the signal it sent to the Chinese community. You have to remember that all of the racial strife in Indonesia against the Chinese did not generate from the bottom; it always began at the top. The Chinese saw Suharto as their protector against detractors in the top ranks. He saw the Chinese as the people who could develop the economy. So essentially he was the one upon whom they relied. When they saw the Fund shutting in the son’s bank, they said, “the old man is finished. The thirty years he’s given us have ended.” That is when the flight of Chinese capital began in earnest.

In the 1980s I nursed two banks in Australia with assets of 150 to 200 billion, as indeed did Paul Volcker during his time as governor of the Federal Reserve with banks in this country. Frankly, if we had cold-turkeyed them, they would have collapsed. There are in Australia lender-of-last-resort facilities, but in the end that is underwritten by the national budget. If you are worried about moral hazard, you’d have some real worries if you inculcate in a generation of bankers that they can be bailed out. So you nurse them through. I believe that shutting banks, for instance, in a crisis like this, was naive at least, and ill-advised—amateur hour stuff.

Goldstein makes many important points. He says that, for the most part,

the Fund's structural policy recommendations reflect the economic profession's consensus on what constitutes sensible structural reform. Well, that's true. Although some serious mistakes in the sequencing of reforms have taken place, Goldstein goes on to say the core of the Fund's programs were appropriate, with the exception of the bad compromise made on bank closures in Indonesia. However, he says, "the Fund's structural conditionality in the Asian crisis and especially in Indonesia appears excessive both in scope and in detail." He goes on, "there were elements of the structural conditionality of the three Fund programs with Indonesia, Korea, and Thailand that seemed superfluous." He says, "I don't find persuasive the argument that trade liberalization measures in the Indonesian and Korean programs were necessary to prevent a slide toward protectionism." Let me underline that. The Bogor Declaration, which was the most ambitious trade declaration of any kind and which was in the course of being adopted at the end of 1992 and during 1993, at the Asia Pacific Economic Corporation (APEC) meeting in Indonesia, brought the Uruguay Round to a close. The Uruguay Round had been going for seven years. We'd had the Europeans fighting on agriculture for seven years against the Cairns group and other agricultural producers. It was only when it became obvious that the Asians and the United States could organize themselves into a trade grouping of some kind that the final impetus to getting the round signed came. At the 1993 meeting of APEC, where the Bogor Declaration was adopted, it was Suharto that championed it as the chair of the meeting. And right through the period, for any observer of Indonesia, his government was progressively deregulating. That cabinet of his was progressively deregulating the Indonesian economy. So the notion that they were going to slide back into protectionism was, of course, a self-serving notion by those designing the program. Moreover, if we look at the postcrisis situation, fortunately, with the exception of Malaysia, all of Asia has gone on to be open. So in other words, the inculcation of free-trade values has actually stuck, despite what's happened. Goldstein did not find persuasive the argument that we needed these things because of the likelihood of a slide toward protectionism. This conclusion is, I believe, correct.

I do not see why the Indonesian program needed to be so sweeping with respect to the dismantling of state monopolies and cartels, the elimination of restrictive marketing agreements, the abolition of showcase projects, and the like, disagreeable as some of these practices were. The car projects were Neanderthal. There is 50 percent more investment in car plants in Asia than the market can use. Again, however, this was trying to be done in the context of a crisis. For confidence reasons, a few candies may have had to be taken from cronies, Goldstein says, but the rest of the box, and admittedly it was a very big box, could have waited until later. He says, moving from the width to the depth of conditionality, the level of detail reflected in the structural benchmarks for these programs likewise seems excessive. For example,

was it necessary in Indonesia to have five conditions to reform oil and gas policy? And eighteen conditions for follow-up actions to the findings of the Bank of Indonesia? Or in Korea, was it essential to have eleven conditions for investment guidelines and for corporate governance of insurance companies? He moves along in that vein.

I think this is the point of the triage list. Someone arrives at a hospital who's had an accident. He has a broken collarbone, a fractured ankle, and a punctured lung. What he doesn't need is a lecture about the evils of smoking. What he needs is a suture on the bleeding within the lung. Do that first. Then worry about the collarbone, and then the ankle. This is why these structural programs were so destructive to the task at hand.

Goldstein goes on to say—somewhat tongue in cheek, but let me quote him—“finally there have been occasions, the Korean and Indonesian programs are important cases in point, when strong pressure from particular G7 countries during the program negotiations resulted in the inclusion of specific structural policies in the Fund program, and this, despite the provisions of the Fund's charter, Article 12, Section 4, for each member country of the Fund, ‘to refrain from all attempts to influence any of the Fund staff in the discharge of their functions.’” Now, from someone so knowledgeable, this is a pretty tough paragraph. What it's saying is that there was too much pressure applied to Fund staff for additions to conditionality.

Now I know Timothy F. Geithner made the point, perhaps validly, that people within Indonesia wanted to use the Fund as a battering ram to put structural conditions into the program, conditions that they thought they'd never get from the government, and the Fund says, “Oh yes, well, we'll put them in.” Well, if you expect nothing of the Fund, you expect it to be wise. When you see people coming, pulling dirty postcards from their sleeves, for structural programs that they cannot secure through their own ministries, you should be wary. But not the U.S. Treasury or the Fund. The fact is, nobody is that naive. This was all happening for a reason.

I do believe, and this is where I disagree with a lot of people, I said yesterday, that at the end of the Cold War, Indonesia's importance faded. There was a view, particularly in the United States, that Suharto was too big a load to carry: okay in the Cold War, not okay now. This came particularly after Bishop Belo and Ramos Horta were given the Nobel Peace Prize. That Bishop Belo should have been given the prize was fine, but someone who had been an active guerilla on the part of Fretilin, the Timor branch of the Portuguese Communist Party, was of course one up the nose of every other person in Timor and the Indonesian government. From that moment on, Indonesia was in trouble, and somewhere along the way people said, it's time they were gone. The key point about Indonesia was that Suharto was already old, so the real issue was about the kind of country there would be after he left.

At any rate, we've been over these issues, and I don't see much product in

going over them further. However, the paper is important in that it articulates the view that mission creep was on here in big doses. At its best, it was distracting, and at its worst, wilful, political, and damaging. As a result, the advised, which happened to be the member governments in the case of Indonesia, turned away from the advisor (the Fund) and decided to run their own policy, and that was of course the end. People may say that we've got an independent democratic structure from it. Well, we have a democratic structure, but whether it has appropriate economic and political authority is still a moot point. However, the cost to Indonesia and its population has been profound. The old families are still there, and frankly they much prefer to deal with the provincial governors than the central government, so this is not going to reduce corruption, I don't believe. I mean, out in the provinces, to where the power has now shifted, we're going to see more of this. We have not yet seen the kind of changes we looked for: we're not seeing assets freed up; we're seeing very crude debt-for-equity swaps. The old families are often still in charge, and instead of the debt, they hand banks a bag of equity, making them a minority equity holder in a business that is still controlled by the family.

None of this is changing much. The army, which has always been an integral part of Indonesia, is no longer in a position of unchallenged primacy. It's still there as an integral part, but it's no longer a decisive part of politics. It's now standing away from it, and it will again have to be dealt with by whoever's running the civilian authority. The problem with all of this is that if you live in Washington, Indonesia's a long way off. However, in our part of the world—Malaysia, Australia—we live with this. Indonesia is the epicenter of southeast Asia, and the importance of this conference is to get focused on some of these matters.

The Association of Southeast Asian Nations (ASEAN)+3 Summit, which is essentially the proposal that Prime Minister Mahatir had for the East Asia economic caucus, has now happened, and you have got ASEAN plus Korea plus Japan plus China looking at Asian solutions to problems. Australia is not there, and the United States is not there. The Chiang Mai initiative, the proposed swaps arrangement, and talk of some sort of Asian monetary fund are happening outside the U.S./IMF orbit.

Let me get a few other prejudices in the marketplace. I believe that if the IMF didn't exist, we'd have to invent it. So I'm not about seeing the IMF deteriorate. I attended my first Interim Committee meeting in 1983, and I attended it for ten years, so I know the Fund reasonably well. I think it's an important institution in this world. However, I don't think we should be unduly worried about other people doing other things. In other words, I think we should keep an open mind about whether there should or can be an Asian monetary facility. I think somebody made the point yesterday about the very high national reserves that countries are now accruing to protect themselves. The notion will occur to them, at some point, they

should have a common reserve. We'll start to see something imitating an Asian monetary facility. The U.S. worry is that it would be dominated by Japan. If it were dominated by Japan, you wouldn't see the crassness we saw displayed in the conditionality programs in Indonesia. Whatever failings the Japanese have for negotiating from under the table and so on, the fact of the matter is that it would have a softer, more, if you like, Asian complexion, than anything that is operated by North Americans or Europeans. I'm not automatically for an Asian monetary fund, but I'm not for ruling it out. I don't think we ought to panic about the fact that people are talking about these things. If we have support facilities, which ease these crises, without adding to the moral hazard problem of making it easier for banks to withdraw, picking up Mervyn King's point from yesterday, about orderly versus disorderly exits, and about standstill and so on, it might be that the IMF doesn't have to carry the full load.

At any rate, the IMF's not getting the funding it needs. The United States has been employing a dog-in-the-manger policy here for years. The long run of all this may be that the Asian crisis brought on some rethinking about where we should go with a modern financial system and how we might deal with crises of this kind, crises that are probably going to occur in the future. A review of this, under Feldstein's leadership at the National Bureau of Economic Research, is, I think, terribly apposite—in fact, high time. The paper written by Morris Goldstein is a brave piece of work, one that is instructive to the rest of us who do not often have that inside knowledge but who worry about the future of countries that strategically are not always the center of attention.

4. Yung Chul Park

I have never spoken to an audience as distinguished as this one, so I have had some slight difficulties preparing this presentation. Instead of commenting on Morris Goldstein's paper, which is extremely well written and a good paper, I am going to talk about Korea's structural reform and restructuring of the financial institutions and corporations since the financial crisis in 1997. During my presentation I will use the terms "we" and "Korea" interchangeably.

I will make a start by talking about recent developments in Korea. As you have already noticed, the economy is slowing down considerably. At present people, including politicians, believe that Korea is still in a crisis, or, if not in a crisis, heading toward another crisis. Well, this perception is rather surprising. Since the financial crisis in 1997, Korea has increased foreign reserve by more than \$90 billion, which is nearly 20 percent of Korea's gross

domestic product (GDP). Korea's GDP grew 10 percent in 1999, and it is expected to grow more than 8 percent in 2000. The latest forecast, adjusted for the inflation, suggests that the economy will grow by 4–5 percent in 2001. Korea has spent more than \$100 billion for restructuring financial institutions and corporations. Recently the government has appropriated another \$50 billion to close down the insolvent financial institutions, not necessarily banks, but also to restructure corporate debt. Yet many people, especially the market participants—both domestic and foreign—believe that basically the major causes of the current looming crisis are due to the lack of progress in corporate and financial restructuring. The complacency among the policymakers who are responsible for the economic reform is another reason.

Now, it is time to think about what International Monetary Fund (IMF) structural policy has meant to a country like Korea. In my view, IMF structural policy had at least three or four fundamental problems.

The first problem was that the purpose and objectives of structural policy were not very clear from the beginning. In the case of Korea, the structural policy consisted of two elements. At the early stage of the crisis, the structural policy was to stabilize foreign exchange markets, domestic financial markets, and the payment systems. Stabilizing these markets required closing down a number of financial institutions and liquidating a large number of insolvent corporations. The second element of the structural policy was an institutional reform, covering the corporations, financial sector, public sector, and the labor market. Also, there was pressure on the further opening of the trade and financial regimes. However, what were the objectives of these policies? The objective of reform is basically to improve the efficiency of the country in the long run. For the reform to be successful, institutional reform must have very clear objectives in terms of time frame. As far as IMF structural policy is concerned, it is really hard to say that objectives were well defined, because many Koreans and market participants thought the structural policy was just designed to get the Korean economy out of the crisis. However, I strongly suspect that was the major objective.

The second problem was that the structural policy did not clearly state the targets of these policies and indicators. If the IMF could have identified it more clearly, it would have been much easier to carry out structural policies. For instance, as far as the corporate restructuring was concerned, we did not have a clear idea of the desired goal of corporate restructuring. For example, the debt-equity ratio: "Should the target be 200 percent? Or lower than that? If the 200 percent debt-equity ratio is the target, then why should it be the target?" There were not clear answers for these questions at that time. If we have to close down many insolvent financial institutions, then who will be responsible for the role performed by these major financial institutions to disappear? The other problem was that there were no indicators suggesting whether the structural policies were carried out according

to the plan. It would be imperative to tell the market participants and other people interested in the structural reform process whether Korea was going in the right direction or not. In fact, Korea had difficulties in checking its performance because of unclear targets and the failure to provide appropriate indicators on structural reforms. Markets could not give clear answers to whether Korea's reform and restructuring were going in the right direction, either. At the same time, the markets were not very interested in understanding the thrust of the structural policies and the progress in Korea as a result of structural reforms.

When the economy is doing well with high growth, nobody raises structural problems. However, when the economy is stuck in a recession, as Korea is now, then people start doubting the economy. From my point of view, at the moment the problems are mainly caused by the adverse external developments: that is, the worsening of the terms of trade and the recession in Korea's major trading countries. Nevertheless, it is still believed that the structural problems are the major causes of the current economic recession and another possible crisis in the near future. I strongly disagree with this thought. If Korea is to step up with the reform and restructuring, then it would not be the right time. After two years of restructuring, labor unions and the politicians were tired of economic reform. As a result, they are not willing to spend any additional money on reform and restructuring, although another \$50 to \$70 billion would be needed to sort unprofitable financial institutions out.

In a democratic country like Korea, it is not easy to just order labor unions and politicians to go on with reform and restructuring. Politicians claim that the government is pushing too far with the reform program through the National Assembly. There is a heated debate going on about what further restructuring should be done in the future. In my point of view, \$50 billion will not be enough to sort out a large portion of bad loans from financial institutions or to get rid of heavy corporate debt. The question is whether we should bail out a large number of financial institutions and corporations. Regretfully, in many cases, the structural policies can become a bailout operation. We should not pay for the cost of cleaning up unprofitable financial institutions. Instead, we should simply let the shareholders and the financial institutions bear the major burden of this restructuring cost. However, this will take a while (six months or one year). The market is unlikely to be patient enough to wait for another six months or a year. Pushed into a corner, the policymakers will have to bail them out. In other words, this restructuring is creating very serious moral hazard problems. Initially after spending \$100 billion, the Korean policymakers felt that Korea was in a position to leave the restructuring process to the market force, to minimize the moral hazard problem. However, as soon as the market participants saw the deterioration in the macroeconomic figures, they started putting pressure on the government to do something about the restructuring.

ing. What they demanded was a bailout of many financial institutions and of corporations that should be liquidated or placed under court receivership. This is what was happening.

Finally, the IMF structural policy was not successful in Korea to minimize the chances of another crisis. Over the two-year period, Korea has introduced all sorts of institutional arrangements designed to deal with the structural problems. In any economy there are unprofitable corporations that should be liquidated. The market itself must take care of the restructuring process. In order for the market to do it, a large number of institutions has to be improved. For that purpose, we introduced these institutions, and we should give these institutions some tasks. However, Korea does not seem to have the time to let the institutions take care of these structural problems. It is always the case that the government is asked to jump into the process and spend quite a lot of money, and the problem creates very serious moral hazard problems.

There is one point that I would like to make about Goldstein's paper. It is that the article said the structural problems were the main causes of the crisis. I also believe that structural problems were significant, and they are still not negligible. Yet clearly the main causes of the crisis are not structural problems. These problems obviously deepened and exacerbated the crisis, but they are unlikely to have been the direct causes. On this question there are thousands and thousands of publications that Goldstein tends to ignore entirely. To be precise, he should refer to this growing literature on the precise causes of the East Asian crisis, particularly in the case of Korea. The causes are important because the IMF or any other international financial institutions would have to correctly understand causes if they were to design their structural policy. When Korea was heading toward the financial crisis in 1997, neither the World Bank nor the IMF fully understood the extent and severity of Korea's structural problems. We acknowledged these problems, but we did not imagine they were significant to put the whole economy down. At the same time, the IMF thought the economic fundamentals of Korea were strong enough to fend off the contagion from financial turmoil from Southeast Asian countries. Unfortunately, that was not the case.

Once we understood the causes of the crisis more precisely, it would be easier to develop more consistently structural policy framework, in terms of the objectives, targets, and time frame. Nobody believed at the time that Korea would be able to manage the reform and restructuring over a three-year period. I still wonder why Korea had to complete the structural reform within three years. In my point of view Korea ought to continue with the reform for another three or five years, depending on the targets and the objectives of the structural reform. Well, Korea may have to spend at least another \$50 billion or more, in addition to the \$50 billion they have appropriated for this purpose. We are keen on what could be done to im-

prove IMF structural policy at this stage because we have not completely overcome the crisis and more reforms and restructuring have to be done. In this respect, I think Goldstein's paper is a very important contribution, and I am sure that many other countries, including a country like Korea, will learn a great deal from his paper. However, once again, it focused too much on East Asian countries and their structural problems. In my point of view, his argument is not fair as a generalization.

For the time being, we should give attention to some of the obvious problems in the international financial markets. For example, a large number of fund managers influence world capital flows and cross-border financial transactions. When they decide to invest in emerging markets, they are concerned about only three variables: (a) the growth rate as a benchmark for the rate of return on investment; (b) changes in the foreign reserve level, that is, current account balance to check the creditworthiness; and (c) other fund managers behavior to see if they should stay or they should move out of the country. In this state of affairs, we should pay a little more attention to problems of international financial markets and how the international financial system is able to address these problems.

Discussion Summary

Jack Boorman reported on internal IMF work on structural conditionality that adds to the information in Morris Goldstein's paper. He agreed that the number of structural conditions in IMF programs has increased substantially since the late 1980s, a fact that he attributes to the attention given to growth as an objective of fund-supported programs and to the concentration on transition economies. Although conditionality is most pronounced in programs designed to deal with structural problems, he said that it has also become more prevalent in standby agreements. He said it is important to keep in mind that structural conditionality is concentrated in a few areas, notably the financial sector, fiscal reforms, the trade system, and other areas in the direct mandate of the Fund. He also cautioned against judging the extent of conditionality by simply counting the conditions. Often the authorities want guidance on the specific steps needed to reach a particular goal. Even so, he admitted that within the Fund there is broad agreement that the institution went too far in certain cases. The hard question, however, is if the Fund is to "pull back," by what criteria it is going to do so. Boorman said that structural measures needed to be "macro-relevant": the financial sector is central to macroeconomic performance, but the performance of the corporate sector is key to the performance of the financial sector. The question is where to stop. He added that if the Fund is

not going to go beyond its more narrowly defined core areas, some other institution, such as the World Bank, has to take responsibility.

On the issue of responding to pressure from domestic reformers to put things into programs that they otherwise would not be able to enact, Boorman said that Goldstein wants the Fund to “just say no.” However, he asked if the Fund should say no to people when they believe the reforms being advocated move in the right direction. He gave an example of a prime minister in an Eastern European country that wanted accelerated privatization as part of a program. *Martin Feldstein* responded that the prime minister in a democratic country should be told that if privatization is not central to the technical problems that the IMF is dealing with, it would not subvert the democratic process by including it in the program.

Turning to the pressures put on the Fund by its major shareholders, *Boorman* reported that the U.S. Congress has put over forty mandates on the U.S. executive director in the Fund to go into all kinds of areas. He said that there should be a better mechanism for deciding “what that staff should be interested in and what the staff should be pressing.” Here he picked up the much-commented-upon example of the clove monopoly in Indonesia. This monopoly diverted income from poor clove producers to those that had the monopoly on exports. Removing the monopoly led to an immediate increase in the price of cloves to the poor farmers. When Suharto reimposed the monopoly at the behest of the exporting monopoly, the price went back down. Taking this as an example of a contentious structural condition, he asked: “Is this something we should or shouldn’t do? Do we care about poverty?” When poverty—and governance—can be affected so directly and substantially by this kind of measure, should that be ignored by the Fund? He added that similar questions arise when the Fund is dealing with marketing boards, the prices of other agricultural products, and the like. Finally, Boorman commented on what he sees as an inconsistency in the criticisms of the Fund from some quarters. He said that some—including the Meltzer commission—are pushing the Fund to move to “preconditioning,” and it is doing this to a large extent with its Contingent Credit Line (CCL). In this, the Fund is told to look at a variety of things, including the soundness of the country’s financial system, the relationships it has with its creditors, its adherence to certain standards, and so on. Yet when the country is in a crisis, the Fund is supposed to restrict itself to a much narrower focus.

Nicholas Stern addressed the evolving division of responsibility between the World Bank and the IMF. He said that whatever the division of responsibilities, we should be thinking of simplifying and streamlining conditionality rather than abandoning it. With so many crises having their source in structural problems—he gave Russia as an example—it would be negligent for the Fund to ignore structural issues. However, he added that the Fund must recognize that it often lacks competence in these areas. On the other hand, the World Bank has longstanding experience in such areas as rural

agriculture and land reform issues that can be useful in advising on structural reforms.

Turning to concrete steps that have been taken, he pointed to the World Bank's new Poverty Reduction Support Credit (PRSC), which is to be used in conjunction with the Fund's Poverty Reduction and Growth Facility (PRGF). The PRSC is more social and institutional, whereas the PRGF is more macro and financial. The idea is that these facilities should move in parallel. Stern hopes that the new facility will allow the World Bank to overcome the problem of slow response that has plagued it in the past. Regarding other desirable changes that would make for more efficient response from the World Bank, Stern said that each country director should have a two-page description of structural and social conditionalities that would be required in the event of crisis lending. He added that if the director can't produce such a statement, "then it is hard to think of what he or she is actually doing there."

Finally, Stern addressed how to decide on the priorities for structural conditionalities. He said that the selection should be guided by two principles that follow from the objective of poverty reduction: (a) achieving growth, and (b) giving poor people a chance to participate in growth. The growth perspective draws attention to conditions that affect the investment climate—macro stability, governance issues including bureaucratic harassment, administrative issues, the financial sector, and so on. The participation perspective draws attention to issues such as education and public health. Together "these two ways of looking at [structural conditionality] should help us construct a focus that I think all of us would agree that the Bank could do with," said Stern. *Feldstein* asked Stern if he sees that social and institutional conditionality—for instance improving schools in a poor developing country—as helpful in resolving the current crisis, preventing future crises, or making the country in question a better place. *Stern* answered that this would help over the long term to reduce poverty. *Feldstein* followed up by asking if this condition would be in the two-page document held by the country director listing the conditions for getting assistance. To this *Stern* replied that the purpose of a condition would be made clear in the strategy document that lies behind the condition, adding that what should be in the two-page document is that social programs be protected in the adjustments that come in crises.

Larry Summers made three points. First, drawing on his experience with the Mexican rescue package, he said that he has reluctantly concluded that collateral for loans from the international financial institutions does not offer a workable substitute for conditionality. Arranging for collateral is a vastly more complicated business than almost anyone who writes about it supposes, he said. Moreover, if good collateral is available, it ought to be available to private-sector lenders. He said that the confusion on this issue reached its "apex in the Meltzer Commission's suggestion that local cur-

rency tax receipts of sovereign governments be used as a potion [of the collateral].”

Second, he sees a lot of “potential for mischief” in World Bank–IMF cooperation on conditionality. Those who like the idea of structural conditionality but dislike IMF mission creep support this idea, he said. However, he sees the potential for a proliferation of conditions and delay as both institutions seek to have their priorities included. The other possibility is that the World Bank won’t provide much money in the time of a crisis because it doesn’t want to be seen as a “money pump,” with the result that the structural element will be lost from the program.

Finally, on Indonesia, he said that, although mistakes were made, it was not an obvious failure of wisdom to trust President Suharto’s economic leader of thirty years for guidance on what to include in the program. Responding to Paul Keating’s description of excessive and misplaced conditionality, Summers said that the hard question is what to do when the government leader is transferring substantial funds to his family and friends. This takes on special importance when one is transferring one’s own taxpayers’ money to the country. He said that the critics should set out a counterfactual history of what they would have had the Fund do and how they think things would have worked out.

Domingo F. Cavallo said the Fund and World Bank will never get good results if they try to impose structural policies. He said the only way to implement reforms in a country is to rely on the political and economic leadership in the country to carry them out, so the Fund and World Bank should be looking for opportunities to support good reforms.

John Crow said that consideration should also be given to the World Bank reviews and IMF consultation papers that come before a crisis. If an institution is to impose structural conditions at the time of a crisis, it needs to have been involved in consultations about the country beforehand.

Arminio Fraga said that in a crisis the Fund should worry about crisis management, and only crisis management. He said nothing should be done to hurt the main objective. On letting legitimate governments add things to the program, he said such additions should be allowed, but kept general.

Responding to the criticisms of Paul Keating and others, *Jeffrey Frankel* offered an additional defense of what he termed “enhanced conditionality.” In Indonesia, Korea, and Thailand, there has been a movement toward democracy. He said we told civil-society types in the past that globalization would lead to growth and growth would lead to political liberalization.

However, it was not clear what the mechanism would be. The mechanism in East Asia in the 1990s turned out to be financial liberalization plus crisis plus conditionality. The IMF did not set out deliberately to overturn any governments, and to do so would of course have been an unacceptable violation of countries’ sovereignty. However, in the Korean election of November 1997, due to the financial crisis, the incumbent president was de-

feated for the first time by an opposition party candidate, Kim Dae Jung, a man who was willing and able to accept the need for reform. President Suharto in Indonesia was arguably brought down in 1998 by the combination of structural conditionality in the IMF program and his own unwillingness to curb his family's economic interests. In each of these countries, a side effect of the crisis was a peaceful step in the direction of democracy. This political pattern is not in itself a good argument for undergoing a financial crisis. However, it belies the argument that IMF conditionality works to undermine the forces of democracy in the victim countries.

Charles Dallara pointed out that the inclusion of structural elements in IMF programs really began "gathering steam" in the 1980s. On the issue of the appropriateness of more recent conditionality, he said he agreed with Timothy F. Geithner that in today's world of free capital markets the international institutions must be concerned with issues such as strengthening financial sectors and addressing corporate governance. This follows from the Fund's fundamental concern with restoring a sustainable balance-of-payments position. In today's capital markets, restoring confidence requires that the international institutions address the concerns of international debt and equity investors. Confidence depends to a significant degree on issues such as the strength of the financial sector and minority shareholder rights. However, Dallara is not convinced that, just because there needs to be a comprehensive approach, it all should be part of Fund conditionality. He said the lack of an integrated approach utilizing the World Bank, the regional development banks, the Bank for International Settlements, and the Basel committee is one reason why there has been so much Fund mission creep. Bringing about this integration requires a "more brutal approach toward managing these institutions, and a more consistent shareholder attitude," he said. Without this, the Fund will be pushed to address issues fundamental to restoring confidence while being criticized for having too many conflicting objectives and lacking necessary staff expertise.

David Lipton argued that we need a realistic conception of program ownership. He said it is a mistake to think that there must be broad agreement across the political spectrum. "If we had settled for what the Korean government was interested in doing on December 2 [1997], we would have had no basis for going forward," he said. Regarding what should be part of a fund program, Lipton said that whatever is essential for restoring confidence has to be included. He recalled that the Korean government had resisted many of the demands for structural reform, including, for example, foreign ownership of banks. He added that we should judge these elements by whether they "helped to give a sense that Korea was going to head in a direction that would make it stable." Turning to Indonesia, he said that the Fund should not be criticized for including too many structural elements, but it should be criticized for "losing sight of the centrality of monetary policy." From November 1997 through February 1998 large liquidity credits

were given in the name of stopping runs on banks, but it “was basically money being given away to cronies,” Lipton explained. Lipton concluded by saying that the program has to “add up to be convincing, especially in a panic.” Conditions should not be disqualified from consideration because they take a long time to have an effect or are fundamentally about efficiency. What is important, he said, is that these are seen as important first steps in useful directions.

On the issue of conditionality, *Edwin Truman* strongly agreed with David Lipton when he said that conditionality should be seen as a package. Truman said it is sometimes difficult to determine at the time what the “essential elements” of a credible package are. One reason is that the audience is varied: domestic residents, domestic leaders, foreign lenders, international financial markets, international institutions, and foreign officials who must authorize positive votes on programs in the international financial institutions. Truman noted that Guillermo Ortiz referred to U.S. insistence in early 1995 that the Bank of Mexico modify its previous practice of releasing information on its reserves only three times a year and adopt a policy of regular releases at least monthly. Larry Summers referred to the insistence that the Thai authorities reveal at the end of August 1997 the extent of their uncovered forward position. Truman was involved in both of these episodes. In the Mexican case, the Federal Reserve had long been troubled by the Bank of Mexico’s policy. Along with the treasury, in early January 1995, the Federal Reserve conditioned access by the Bank of Mexico to the use of a drawing on the Federal Reserve’s swap lines on such a commitment. It took the Bank of Mexico an entire weekend to agree. This agreement was important not only on substantive grounds (although some might argue that by itself it was trivial), but also because the action by the Bank of Mexico also helped to restore the Bank of Mexico’s credibility in the eyes of the U.S. authorities. Essentially the same argument applied in the Thai situation. The central bank of Thailand had lost credibility with the Federal Reserve, and several other (but not all major) central banks, because of the way it had built up its forward exposure in secret. From this perspective, the credibility of the Thai package was enhanced by the central bank’s reluctant agreement to reveal its forward position. These actions may not have been important to all observers or officials, but they were in each instance key to Federal Reserve support.

