

## **THE IMF AND ASIA**

A series of four articles by Martin Khor on the role of the IMF in the Asian crisis.

The four articles written in 1997 provide a survey of the criticisms against the IMF's policies, performance, processes and motivations.

1. IMF Policies in Asia Come Under Fire;
2. IMF Policies Leading to Foreign Control of Asian Countries;
3. IMF: Bailing Out Countries or Foreign Banks?
4. IMF Policies Make Patient Sicker, Say Critics

1st ARTICLE in a series on The IMF and Asia

## **IMF POLICIES IN ASIA COME UNDER FIRE**

By Martin Khor  
Director, Third World Network (Penang, Malaysia).

**SUMMARY:** There has been a mounting wave of severe criticisms of the IMF's mode of operations, policy conditions and even motives for the "rescue packages" it has coordinated for Thailand, South Korea and Indonesia. The IMF policies have not restored stability but may instead have contributed to further erosion of confidence, as evidenced by the further sharp downturn in the region's currencies, stock markets and economies since the IMF aid came into operation. Even establishment economists and media have turned their guns on the IMF, once regarded as the oracle of financial and economic wisdom.

-----

DOUBTS AND CRITICISMS are mounting about the role and policies of the International Monetary Fund in Asia as the region's economies continue to reel from currency and stock market declines despite the IMF-managed "bail-out" of Thailand, Indonesia and South Korea.

On 14 December 1997, the political leaders of Thailand, Malaysia and China attending an Asean Summit meeting in Kuala Lumpur expressed concern that the recent IMF aid had not brought recovery to the region.

Reporting on the bilateral talks between Malaysian Prime Minister Dr Mahathir Mohamad with Chinese President Jiang Zemin and Thai Prime Minister Chuan Leekpai, Malaysian foreign minister Abdullah Badawi said: "The IMF has not brought immediate recovery...It is a fact that the situation has worsened. We thought that when the IMF got in things would improve. However the situation is getting more difficult."

He added that questions were being raised whether the IMF was helping the situation or causing more problems. "The IMF has been successful in Mexico but it doesn't seem to work for us. Maybe we can't give Panadol to everyone...Some are allergic to it and the illness becomes worse."

Abdullah also reported that the Thai Premier said the IMF's assistance to Thailand had not borne any significant result and that he feared the assistance may be "too late" to rejuvenate the country's economy.

In the past few weeks, there has been a torrent of increasingly sharp attacks on how the IMF is operating in Asia, the negative effects of its policies, and even its motives, or in whose interests it is actually working.

Significantly, the criticisms are coming not only from politicians, labour unions and consumer groups of the region, but also from establishment economists and the mainstream international media.

One reason for this swing in opinion is the spectacular failure of the IMF rescue packages in restoring confidence or stability in the currency and stock markets of South Korea, Thailand and Indonesia, the three recipient countries.

It had been expected that a recovery process would begin once these countries fell under the discipline of the IMF. Instead, the policies imposed on them by the IMF (including severe economic contraction and a prohibition on aiding troubled local financial institutions and corporations) seem to have created more (rather than less) fears of impending economic collapse.

In December 1997, the region suffered further financial stress and turmoil as the currencies in South Korea, Thailand and Indonesia fell to new lows several times during the month.

The South Korean won fell continuously on news of merchant bank closures, fears of coming collapses of its giant corporations, and speculation on impending debt default. Tough policies forbidding official help to ailing local institutions are part of the IMF's conditions.

Ironically, the fears fuelling the currencies' falls are becoming a self-fulfilling prophecy as it is the sharp decline in currency values that is a main factor in driving the region's indebted companies and countries into deep trouble.

When the Malaysian Prime Minister Dr Mahathir Mohamad declared his nation's intention to avoid seeking loans from the IMF, he became the first political leader in the region to explicitly criticise the policies the agency attaches to its rescue package for Asian countries.

At an interview with senior Japanese journalists in Tokyo on 28 November, Mahathir said although he could not discount the possibility of Malaysia having to seek IMF aid, "we will resist it as much as possible."

He criticised three conditions tied to IMF loans: that the country must open up its financial market, resulting in powerful foreign banks buying up local ones; interest rates would have to be raised, which would stifle business growth; and taxes would be raised, burdening

the people already hit by a depreciated currency. "All these conditions are designed to enable the countries to pay back their debts to foreign banks and institutions so that they will get back their money but the people will suffer," he commented.

On 1 December, speaking at the Asean Finance Ministers' meeting in Kuala Lumpur, Mahathir said the IMF offers to lend money with which to repay loans to foreign lenders. "But the loans come a string of conditions, principal among which is the opening of the financial sector to full foreign participation. It is likely that this will result in foreign banks eventually dominating the finances of the country concerned."

Some observers felt the Prime Minister had been too outspoken in attacking an institution that many people consider the oracle of economic truth and the guardian of financial prudence. Instead, it appears he started a trend.

The IMF is increasingly being blamed not only by the local people in affected Asian countries, but also by the international media that normally supports the kind of free-market orthodoxy championed by the IMF.

In South Korea, there have been almost daily demonstrations, street protests and signature campaigns by labour, consumer and public organisations against the IMF's policies, which are seen to be imposing a new imperial "trusteeship" on the country.

News reports and opinion pieces critical of the IMF's Asian policy have been appearing frequently in newspapers and TV programmes in South Korea, Thailand and Malaysia, as well as in international newspapers such as Financial Times, the Wall Street Journal and the International Herald Tribune. Even an early December issue of Time magazine had a critical cover story with a title that reflects the rising doubts: "The Great Asian Bailout: Will the IMF save the region's economies -- or make things worse?"

The major criticisms being made by the wide range of critics include the following:

\*\* Some of the IMF's conditions are forcing the countries to give up their existing policies protecting domestic companies and local interests and instead to rapidly or fully open up their economies (especially in the financial sector) to foreign corporate ownership.

\*\* The IMF has been influenced or manipulated by the US and other rich nations to put in these conditions so that their companies can gain market access to the countries concerned, now that they are in a vulnerable state. What these rich countries were unable to do through bilateral or multilateral (particularly WTO) pressures, they are now

getting by using the IMF loans as leverage.

\*\* The IMF practices double standards in favour of international banks and against local financial institutions, companies, depositors and shareholders. On one hand it insists that the governments play by strict market rules and not put in money to aid ailing local financial institutions and companies. But on the other hand it wants the governments to pay back all the external loans contracted from international banks, including the huge debts of the private sector that have gone sour. The foreign banks will in other words be given gigantic subsidies so they do not have to suffer for their mistakes, whilst local banks and companies are forced to go under.

\*\* Other key IMF conditions, especially the raising of interest rates, tightening of credit, cuts in government spending and induced general contraction of the economy, are misplaced in the Asian context as they had been designed for countries (mainly in Latin America and Africa) facing a different set of problems (high budget deficits and large foreign debts originating in the public sector).

Applied to the Asian countries, the standard IMF policies are counter-productive as the Asian public sector does not have a problem with budget deficits or high external debt. Their problems are centered instead on the private sector. Whilst the real economy had been sound, there was a financial panic partly catalysed by speculators, leading to the crash in currency and stock market levels. This broke the backs of many private companies (which had accumulated high foreign debts) and private banks (which had already faced a high ratio of non-performing loans due to over-extension of credit to non-productive sectors).

What is required in the Asian countries is a restoration of the confidence of investors and depositors (including local ones), and a programme of recovery of private institutions, both of which also require greater stability in the currency rates. However, the IMF policies of tightening fiscal and monetary policies, high interest rates and prohibition of aiding local institutions will cause an economic contraction and further weaken or kill off key local private-sector institutions. Thus instead of boosting public and investor confidence (what is most needed in Asia), the policies further erode confidence, and this will keep currencies and share values low or make them plunge further.

\*\* The IMF's policies are made by staff who do not adequately understand the countries they are presiding over. Yet these staff members are put in a position to (in a very short period of days) design and even radically alter policies of whole economies which up to now have been doing so well they had been long held up as models of economic success.

\*\* The IMF preaches about the need for governments, banks and companies to be open and transparent, but its own operations are conducted and its policies are made in secrecy. The theoretical basis of its policy conditions are not revealed and even the conditions themselves are not made public, and thus are not subject to review by independent professionals.

The IMF talks about everyone else's need to be open, but the public is not given the chance to participate in its decisions. Leaving aside the issue of public participation, even the governments which are recipients of the IMF loans have little leeway to negotiate on (let alone take part in the design of) the policies that are tied as conditionalities to the loans.

The series of critical comments has become more numerous and more potent because of sinking confidence in the IMF's performance. Initially, at the start of the Asian crisis, there had been wider belief that the IMF's policies were tough but necessary to correct previous practices and policies, and they should be taken as a kind of bitter medicine that would eventually cure the patient.

However, independent economists and even market analysts are no longer willing to take the IMF prescription as sacred and are now warning governments and the public against accepting it on the basis of "blind faith."

Even more powerful than the critics in eroding confidence in the IMF's performance is the lack of progress of those economies that have been forced to undergo its medical treatment.

Whilst the markets initially welcomed their seeking IMF help, South Korea, Thailand and Indonesia in recent weeks and months have endured even greater agonies of falling currency and stock market levels.

There is a lack of confidence in the market itself that the policy conditions tied to the IMF rescue will lead to recovery.

(This is the first in a series on IMF policies in affected Asian countries).

MARTIN KHOR is the Director of the Third World Network, whose International Secretariat is based at 228 Macalister Road, Penang, Malaysia. Tel: 60-4-2266159; Fax: 60-4-2264505; EMail: twn@igc.apc.org.

-----

2nd Article in a series on The IMF and Asia

## **IMF POLICIES LEADING TO FOREIGN CONTROL OF ASIAN COUNTRIES**

By Martin Khor  
Director, Third World Network (Penang, Malaysia).

**SUMMARY:** One of the greatest fears of a country that is forced to seek IMF assistance is that the policy conditions that come with such loans would spell the end of that nation's economic sovereignty. These fears are already becoming a reality in Thailand and South Korea, where conditions attached to their IMF loans have led to policy changes that pave the way for foreign institutions to take over the domestic financial sector as well as other parts of their economies. Foreign banks and companies are already going through the wreckage of these economies and beginning to pick up local assets and institutions at bargain prices.

-----  
ONE OF THE major criticisms of the recent rescue packages of the International Monetary Fund in Asian countries is that they would end the economic sovereignty of the countries having to seek its assistance.

These nations would no longer direct or control their own economic or social policies. In particular, policy conditions tied to IMF loans would pave the way to foreign ownership and domination of the economy, especially in the financial sector.

One of the most outspoken critics of the IMF, Malaysian Prime Minister Dr Mahathir Mohamad, recently warned that powerful nations had been given the opportunity of the present financial problems to force open the economies of East Asian developing countries and to possibly dominate them. He mentioned in particular that the IMF conditions would include policy changes to enable large foreign banks to take over the financial sector. These predictions are already coming true.

The IMF has imposed on Thailand and South Korea the condition that they must allow higher foreign ownership of their economy, especially in the financial sector. According to domestic and international media reports, the market access conditions were believed to be placed in the IMF package (at least for South Korea) at the insistence of the United States.

This in fact was strategically the most crucial of the IMF conditions, which was also an "extra bonus", outside of the IMF's normal

macro-economic conditions (such as raising interest rates, reductions in government expenditure, economic growth and the current account deficit).

As part of its deal with the IMF, Thailand was asked to allow foreign banks to own more equity in the local banking sector.

In October, the government announced it would allow foreign institutions to hold a majority stake in operating financial institutions for up to ten years, after which any further capital increases would have to be sold to local investors if the foreign share is more than 49 percent. (Bangkok Post 12 Nov 1997).

This opened the door for foreign banks to take advantage of the present situation and quickly raise their share of the banking business. The local Thai banks are reeling from overdue loans and many are suffering from a weak capital base. Foreign banks are now swooping in to take over the local banks, taking advantage of the latter's present vulnerable situation.

According to the Wall Street Journal (5-6 Dec 1997), the restructuring of Thailand's financial system "is expected to result in foreign majority ownership in many of the country's 15 commercial banks."

On 26 November, the American company Citibank signed a memorandum of understanding with First Bangkok City Bank and said it planned to buy a stake of at least 50.1 percent, although the price was not yet fixed.

This was the first salvo. According to the International Herald Tribune (6-7 Dec 1997): "Meanwhile, word is emerging almost daily of foreign concerns that want to buy finance companies or banks." The foreign companies mentioned are American International Group Inc., Development Bank of Singapore, Credit Suisse First Boston and Westdeutsche Landesbank Girozentrale.

All but two of the 58 troubled finance companies have been closed by the government. One of the survivors, Bangkok Investment Co. has proposed being 80 percent acquired by the American International Assurance subsidiary AIG Consumer Finance Group. (Asian Wall Street Journal 9 Dec 1997).

The latest news is that the Development Bank of Singapore, together with two other Singapore-owned companies, is taking over a majority share in one of the Thai local banks.

In South Korea, the IMF also forced the government to allow foreigners to have a larger share of the Korean economy, which had till then been relatively protected.

According to a Reuter report (5 Dec 1997) on the IMF terms: "Foreign investment in the capital markets will be liberalised and direct



foreign investment procedures will be simplified and made more transparent. Foreign entities will be allowed to buy 50 percent of the equity of a listed Korean company by end-1997 and 55 percent by end-1998, paving the way for foreign takeovers of Korean firms. Foreign banks could be allowed to form joint ventures and set up subsidiaries."

Before the IMF deal, the shareholding limit for foreign individuals was 7 percent in a specific Korean company stock, while the combined foreign shareholding limit was 26 percent in a stock. On 11 December, the ceiling on a combined or individual basis was raised to 50 percent.

According to the Asian Wall Street Journal (9 Dec 1997), US businesses are now scrutinising opportunities created by the IMF measures, which would "open South Korea's financial sector and allow greater foreign ownership of South Korean companies." The biggest potential winners are financial firms, including commercial banks and brokerage houses. "For these companies, the bailout means short-term advisory business and long-term investment opportunities, and expansion of existing operations and investment in Korean firms."

The report adds: "The IMF also is pushing Korea to accelerate the schedule for allowing foreign entry into the domestic financial sector, including allowing foreign banks to establish subsidiaries and brokerage houses by mid-1998. The IMF also wants Korea to remove restrictions on foreign companies' access to domestic money-market instruments and the corporate-bond market. One US banker described the long-term impact of such measures as a "sea change" that could leave US and other non-Korean foreign firms dominating the financial services scene in Korea in a few years, as they have come to do in Japan in recent years."

Another IMF condition is that South Korea must allow Japanese products greater access to its market. Previously, imports of Japanese goods had been restricted because of Japan's large trade surplus with South Korea.

It was also reported that the conditions forcing South Korea to give greater ownership access to foreign companies and more trade access for Japanese goods were injected into the IMF package at the insistence of the US and Japan.

What the US and Japan could not achieve through bilateral pressures on South Korea (the US for instance has been threatening to use its Super 301 trade sanctions to allow its firms greater ease to enter the country), or through negotiations in the World Trade Organisation, they have been able to do in South Korea's moment of weakness and its need for the IMF.

The US is the country which has by far the largest influence on IMF Secretariat policies. Also, the pledges of US\$5 billion by the US and US\$10 billion by Japan to the total US\$55 billion rescue

package gave the two countries the handle with which they could shape IMF conditions.

The South Korean media has criticised how US and Japan used the financial crisis as leverage to force Seoul to open its markets.

"A senior US treasury official...backhandedly manipulated IMF negotiators to push for market opening...while Japan used financial aid as a weapon to prop open the domestic market for their goods," according to an editorial in Dong Ah Ilbo, a big newspaper. "It is highly likely that our economy will be a playground for a handful of international fund managers."

The most recent development is that South Korea has again been pressurised to agree to a new package of even more onerous terms of reforms to liberalise its capital markets and to allow complete foreign ownership and participation of its corporate sectors.

Throughout December, the country's currency and stock market faced a continuous slide. With foreign reserves tumbling, the government made desperate attempts to get the IMF, the US and Japan to release more of the US\$55 billion loan package, in order to prevent the country having to declare a default or debt moratorium.

However, the US refused the requests on the grounds that the reforms already agreed to were not being implemented well enough. With the presidential elections producing a new President-elect in Mr. Kim Dae-Jung, a senior US official began to negotiate with him on the terms of reform.

Finally, as the financial situation turned even more grave, the Korean government, the IMF and the US Treasury were able to announce that \$10 billion of the \$55 billion package would be released to South Korea in the next few weeks, including parts of the funds that had been pledged by the IMF, the US, Japan and many other rich nations.

According to news reports, the acceleration of the funds release came with a heavy price, with South Korea having to agree to faster and deeper "policy reforms." The rich countries were able to extract even greater concessions on behalf of their corporations to have greater access to South Korea.

From media reports, the new concessions include the following:

\*\* Korea agreed to abolish nearly all restrictions on foreign investments in its financial markets and banking sector. Foreign banks and brokerage houses can establish full operations from March 1998.

\*\* Korea agreed to allow foreign investors to acquire 55% of listed companies from 30 December and 100% by the end of 1998. (This compares to 26% before, rising to 50% in mid-December and 55% at end-1998, agreed to less than a month previously).

\*\* The bond market will be fully opened by the end of 1998.

\*\* South Korea is also required to repeal its interest rate ceiling of 40% in two months, decide how to treat insolvent financial institutions within five months, reform labour laws and permit sacking of workers in corporate takeovers.

According to the Financial Times (2-28 Dec 1997): "The full opening of the capital markets will pave the way for foreign takeovers of Korean companies and increase foreign competition in the financial sector, heralding the end of the nation's protectionist economy."

In Thailand, meanwhile, the American Chamber of Commerce is pressing the government to open up the economy further to foreign firms. On 2 December, it called for additional financial liberalisation, lifting of all restrictions on foreign ownership of assets and participation in the services sector and tariff cuts.

It would not be surprising if further loans to the IMF client countries would come with more conditions promoting the foreign firms' access.

These recent developments in the countries undergoing IMF-imposed conditions are a lesson for other countries for they give a clear picture of what could happen if the latter were also to fall under the IMF's spell.

(This is part of a series on the IMF and Asia).

MARTIN KHOR is the Director of the Third World Network, whose International Secretariat is based at 228 Macalister Road, Penang, Malaysia. Tel: 60-4-2266159; Fax: 60-4-2264505; EMail: twn@igc.apc.org.

-----

3rd Article in a series on The IMF and Asia.

## **IMF: BAILING OUT COUNTRIES OR FOREIGN BANKS?**

By Martin Khor  
Director, Third World Network (Penang, Malaysia).

**SUMMARY:** The International Monetary Fund is practicing double standards in its loan conditions. On one hand, it insists that local banks and companies should not be aided by the government as this would be against market rules. On the other hand, it ensures the international banks avoid losses by getting the government to guarantee or take over the banks' loans to the private sector. This has earned the IMF the label of chief debt collector for the foreign banks.

-----

THE INTERNATIONAL Monetary Fund is facing growing resentment in Asian countries due to the double standards with which it treats the interests of international banks on one hand, and local institutions and local people on the other hand.

Critics of the IMF have long pointed out that its main role since the 1980s has been as the chief debt collector for international banks.

The banks had lent heavily to Third World governments, mainly in Latin America and Africa. When these countries defaulted (or were on the verge of default) on their external loans, the IMF organised programmes of debt rescheduling and new loans.

Most of the debts were owed to international banks and Northern governments, which also provided most of the roll-over and fresh loans. Though its own share of the loans was small, the IMF (together with the World Bank) was asked by bankers and creditor governments to coordinate the rescheduling exercise.

The banks and creditor governments would agree to roll over old loans and give new loans only if the IMF gave a good report of the indebted country. This role of chief examiner gave the IMF and the World Bank the power to impose "structural adjustment" conditions on the more than 80 indebted countries requiring rescheduling.

The policies were based on the simplistic philosophy that since governments could not be trusted, the economies should be liberalised (opened to global trade, finance and investment), privatised and deregulated. This drastically reduced the role of the state, which was told not to intervene in the economy.

Even more importantly, the IMF insisted that every dollar of foreign loan had to be repaid. So the IMF conditions placed top priority on government budgets being skewed towards foreign debt servicing, even as social and economic spending was brutally cut.

The international banks and creditor governments got most of their money back. Only recently have some countries had small amounts of their debt stock "forgiven."

The banks avoided losses on their sour Third World loans, and indeed profited from them as neither interest nor principal were forgone, thanks to the IMF's conditions.

Paying the price, most countries coming under the IMF were induced to undergo a long period of recession and austerity, from which they have not recovered. The financial resources saved through cuts in government spending and reduced imports were channelled to pay the international banks. Today, most African countries are poorer and even more indebted, despite 15 or more years of "structural adjustment."

One of the most critical of the IMF conditions in many countries has been that governments have to ensure the banks are repaid the foreign debts not only of the public sector but also of the private sector.

Thus, the repayment of the foreign loans of private companies and individuals had to be guaranteed by the governments, even though these loans had been privately contracted between the international banks and the private sector.

In many cases, the governments had to take over the private sector's foreign debts as the local companies and banks (some of which went bankrupt) could no longer service their loans.

Of course, this is unfair from a commercial point of view. In normal circumstances, if a bank provides a loan to a company or individual, it takes the risk of suffering losses if the customer cannot pay up.

But in many IMF deals with troubled countries, the international banks escape any loss as the governments are asked to assume the private sector's external loans.

This has crucial significance for the Asian crisis, because in Thailand, Indonesia and South Korea, most of the existing foreign loans were contracted by the private sector.

It is not confirmed that the IMF agreements with these countries (which are secret and not open to public scrutiny) also include the condition that the governments undertake to guarantee the servicing of these

private-sector foreign loans.

But the signs are that this is the understanding. On 9 December, Reuter reported on a leaked IMF confidential document on the South Korean crisis. According to the report: "The IMF noted the government on 25 August had said it would guarantee the payment of foreign debt liabilities by South Korean financial institutions but that laws implementing the guarantees were not approved by the National Assembly.

"Market confidence also was undermined by the National Assembly's failure to pass crucial financial sector reform bills, it said. Seoul has promised to adopt the legislation as a condition for the IMF-led bail-out."

There is a practice of double standards in the IMF's approach. It insists on the condition that the client government not spend public funds to rescue or subsidise the country's ailing banks, finance companies and corporations.

This is supposedly on the grounds that market forces should not be tampered with, and local private financial institutions, companies and businessmen that are insolvent should be forced into bankruptcy. Those who have made business mistakes should pay for them. Aiding the private sector would be inefficient and against the rules of the free market.

However, this magnificent adherence to market rules is not to be applied to the foreign banks and financial institutions that have lent in foreign currency to the local private sector. They have to be repaid in full. They are not required to suffer (in fact they are protected from) any losses for their wrong decisions in providing credit to customers that are now insolvent.

Indeed, a large part of the massive IMF-coordinated loans to the three Asian countries may not even end up there. Many billions of dollars of the "bail-out funds" will simply be transferred from the IMF to the governments for re-channelling to the international banks to service mostly sour private-sector loans.

This is tantamount to a massive subsidy to the international banks. Most of the outstanding foreign debts (South Korea US\$200 billion, and over US\$100 billion each for Thailand and Indonesia) were contracted by private companies and financial institutions, many of which are unable to pay back due to the slowdown of exports and business, the currency depreciation and the stock market crash in these countries.

It would appear that the IMF and the creditor countries that are

contributing to the rescue packages want to ensure that the international banks and institutions that (foolishly as it turned out) lent heavily to troubled Asian countries are paid back in full.

This is grossly unfair as the international banks should have done proper investigation before giving out the loans. They took the risk and should bear the cost of their own mistakes.

But the market principle of "let those institutions that made a mistake pay for it," so sacredly held to and insisted upon by the IMF for local institutions, does not seem to apply to the international banks and institutions.

There the contrary principle holds, that it is equally or even more sacred that all foreign loans should be serviced, and the international creditors should not be asked to bear some of the losses.

No wonder the IMF has been portrayed as the chief debt collector on behalf of international banks!

This lends credence to the criticism that the IMF is insisting on austerity and the market rule of "no public assistance" not because it truly believes in the efficiency of markets, but because it wants the affected countries to squeeze out maximum national resources to pay back the international creditors.

Those who have to pay the price are those involved with the ailing local banks, finance companies and corporations. Worst affected are the innocent members of the public that deposited or invested their life savings in these institutions.

At least the majority shareholders know that in business one has to be prepared to lose everything, and they could also have contributed to the debacle through inefficient or unethical practices.

But those many thousands who saved in the financial institutions that are forced to close or suspend their operations (56 finance companies closed in Thailand, 16 banks closed in Indonesia, 14 merchant banks suspended in South Korea) are left wondering when or whether their deposits will be released, even though the governments have assured that depositors (or most of them) will get their money back.

Politicians and citizens who are on the wrong side of the IMF's double standards in conditions placed on their countries are naturally resentful. But even writers in the establishment Western media have castigated the IMF for its priority in helping international banks at the expense of local people.

Philip Bowering of the International Herald Tribune (9 Dec) wrote:

"It is clear to many in East Asia that the surge of short-term capital into the region was the work of Western and Japanese bankers...The sudden actual or threatened withdrawal of much of that capital over recent months was what caused the crisis...

"There is justifiable suspicion that the IMF is there not to help the troubled countries but to bail out international banks. It is indeed curious that the fund (rightly) insists on local banks' being forced to admit losses, close down or be recapitalised. But why not let market forces work their magic in full?

"Why not let the Japanese, European and US banks face the consequences of their own follies? Let them try calling in their foreign currency loans to hopelessly indebted enterprises in Korea, Thailand and elsewhere.

"The IMF may help global financial stability. But who should pay for that? IMF funds are seen in Asia primarily as a bailout of foreign banks, paid for by local taxpayers, shareholders and workers."

Jeffrey Sachs, head of the Harvard Institute for International Development, wrote in the Financial Times (11 Dec): "It is time that the world take a serious look at the International Monetary Fund.

"In the past three months, this small, secretive institution has dictated economic conditions to 350 million people in Indonesia, South Korea and Thailand. It has put on the line more than \$100 billion of taxpayers' money in loans.

"These bailout operations, if handled incorrectly, could end up helping a few dozen international banks to escape losses for risky loans by forcing Asian governments to cover the losses on private transactions that have gone bad. Yet the IMF decisions have been taken without any public debate, comment or scrutiny."

Commenting on the pressure on governments to take over the payment of bad private-sector loans, a senior Malaysian commercial litigation lawyer, Mr Gurdial Singh Nijar, said: "It is a fundamental principle of contract law that only parties to a contract have rights and obligations.

"So if there is a contract between a foreign lender and a local borrower, it is not right to impose any obligation on anyone else upon the breach of any terms of the contract."

Nijar said that in Commonwealth countries this was a central concept known as "privity of contract".

"To impose fresh obligations on a government in respect of a failed



contractual relationship is not only unfair but against this basic legal tenet. Thus if this were proposed as an IMF condition it would be improper and the government is within its right legally to refuse this obligation on this basis."

Nijar added that if a local company could not service its foreign-currency loan from a foreign bank, the bank take action to realise the securities on which the loans are given.

"It can act to wind up the company and realise its assets to pay back at least part of the loan. And if there are guarantors for the loans, they too can be sued."

Since these actions can be legitimately taken by the international banks, concluded Nijar, they should not be given the added privilege that their non-performing loans to the private sector be now guaranteed or taken over by the government.

(This is part of a series on the IMF and Asia).

MARTIN KHOR is the Director of the Third World Network, whose International Secretariat is based at 228 Macalister Road, Penang, Malaysia. Tel: 60-4-2266159; Fax: 60-4-2264505; EMail: [tw@igc.apc.org](mailto:tw@igc.apc.org).

-----

4th Article in a series on the IMF and Asia.

## **IMF POLICIES MAKE PATIENT SICKER, SAY CRITICS**

By Martin Khor  
Director, Third World Network (Penang, Malaysia)

SUMMARY: Perhaps the most devastating criticism of the International Monetary Fund in the present situation of the Asian crisis, is that its policies imposed on South Korea, Thailand and Indonesia are wrongly designed and have further worsened the situation. Instead of quietly encouraging the international banks and the rich countries to extend more credit to the affected countries and boost investor confidence, the IMF chose to squeeze the countries further, thus driving their banks and corporations to deeper crisis, and worsening investor confidence.

-----

IN ITS HANDLING of the Asian crisis, the International Monetary Fund is coming under severe attack for its objectives, the substance of its policies, and its institutional processes.

Questions are also being asked about its inability to manage global financial stability and prevent crises due to its almost religious belief that the market can do no wrong and its stubborn refusal to recognize the need to supervise market forces.

One thing is clear: the IMF has become an even more powerful agency, deciding the policies and economic fate of hitherto high-growth South Korea, Indonesia and Thailand, in addition to the 80 other developing countries that come under its "structural adjustment" loans.

Which is why its governance and method of operations is a great source of concern. The IMF, like the World Bank, is controlled by the few rich countries by virtue of their overwhelming share of the Fund's total capital, since voting is weighted according to the capital shares that countries own.

With 28 percent of the capital, the US has a dominating say of the IMF's overall policies and direction.

The IMF Secretariat in Washington works in secret, drawing up policies for the 80 countries under its control, largely without their participation and without the knowledge of the world. The IMF "agreements" with the countries are not normally publicly revealed.

The IMF's monopoly of power over policies (with no prior open professional or public debate over their theoretical or practical basis) and its almost total lack of "transparency" in decisions and decision-making process is in ironic contrast to its shrill preaching to its client states to fully open up to competition and transparency.

In an devastating attack, an Editorial in the Asian Wall Street Journal (AWSJ) of 24 November 1997 says the Fund is "one of the most secretive institutions this side of the average missile base." The IMF has 2,300 staffers in Washington, representatives in Central Banks of troubled countries, and sends forth teams analysts, advisers and overseers.

"But what they do, or learn, or exactly what guides their decisions, is largely kept secret," says the AWSJ. This leads to confusion, for example when the Fund supports Hong Kong and Argentina in pegging their currencies, but favours currency floats in Southeast Asia. "How the Fund decides in a given case is anyone's guess."

The editorial says similar mysteries shroud the IMF's rescue packages for Thailand, Indonesia and South Korea, even though vigorous public debate is now needed. It concludes: "Fund officials, as well as their colleagues at the US Treasury, have recently been touting the virtues of transparency...Start by unclocking the IMF."

In the Financial Times of 11 December 1997, the head of the Harvard Institute for International Development Jeffrey Sachs says the IMF pays lip service to transparency, but offers no public documentation of its decisions, except brief press releases without the details needed for professional evaluation of its programmes. IMF staff are unaccountable for their decisions.

"The people most affected by these policies have little knowledge or input," adds Sachs. "In Korea the IMF insisted that all presidential candidates immediately "endorse" an agreement they had no part in drafting or negotiating, and no time to understand. The situation is out of hand...It defies logic to believe the small group of 1,000 economists on 19th Street in Washington should dictate the economic conditions of life to 75 developing countries with around 1.4 billion people."

From criticisms of how the Fund works, many economists are now also attacking the substance of the IMF's policies for Asia.

Sachs estimates there is an average of seven IMF economists dealing with a country, too few for the IMF to get a sophisticated view of what is happening. "The IMF threw together a draconian programme for Korea in just a few days, without deep knowledge of the country's financial system and without any subtlety as to how to approach the problems."

In its annual report just three months ago, the IMF directors "welcomed Korea's continued impressive macroeconomic performance and praised the authorities for their enviable fiscal record". The report also said "directors strongly praised Thailand's remarkable economic performance and the authorities' persistent record of sound macroeconomic policies."

Sachs attacks IMF director-general Michel Camdessus, who "with a straight face... now blames Asian governments for the deep failures of macroeconomic and financial policies that the IMF has discovered."

Implying the IMF has its diagnosis and cure all wrong, Sachs says a basic truth about the Asian situation is that "there is no fundamental reason for Asia's financial calamity except financial panic itself. Asia's need for financial sector reform is real, but not a sufficient cause for the panic, and not a justification for harsh macroeconomic policy adjustments.

"Asia is reeling not from a crisis of fundamentals, but from a self-fulfilling withdrawal of short-term loans, one that is fuelled by each investor's recognition that all other investors are withdrawing their claims. Since short-term debts exceed foreign exchange reserves, it is 'rational' for each investor to join in the panic."

Sachs attacks the IMF for making the situation worse. Without wider professional debate, it imposed a severe economic contraction in these economies on top of the market panic.

With an unrealistically low inflation target, the IMF imposed a brutal monetary squeeze in Korea, causing its interest rates to jump. The Fund argues these measures are to "restore and sustain calm in the markets", but Sachs says it is hard to see how recessionary monetary policies will restore calm.

"Indeed the panic has so intensified since the signing of the agreement that Korean banks may now be on the verge of outright default."

The IMF also told Korea to tighten fiscal policy by 1 to one-and-half percent of GDP, reduce growth and suspend nine merchant banks. None of this overkill makes sense for a country with sound macroeconomic policies.

According to Sachs, a better IMF approach should have stressed Korea's strengths rather than weaknesses, thereby calming markets rather than further convincing them to flee the country. Months ago the IMF could have encouraged Japan, US and Europe to give credit support to the Bank of Korea, and encouraged major banks to roll over short-term debts.

With confidence-building measures, Korea could probably have got by with a modest growth slowdown, no credit crunch and complete financial reforms in a few years.

Sachs concludes that the IMF should not be given so much power, that its Board should oversee rather than rubber-stamp the staff's proposals and consult outside expertise, and its operations should be made public and subject to professional review and debate.

Making many similar points was Financial Times columnist Martin Wolf on 9 December: "Like deer, investors graze happily for a while, ignoring the perils of predators asleep nearby. Then, when startled, they stampede. These are the skittish beasts that the IMF is trying to cajole back to their wonted east Asian feeding ground. The question is whether it is doing this in the best possible way. The answer is no."

Wolf describes three objections to what the IMF is doing. Firstly, by imposing a tough economic squeeze in affected countries, the IMF risks undermining, not restoring, investor confidence. Secondly, by insisting on faster liberalisation of capital inflows, the IMF may exacerbate financial vulnerability. Thirdly, these vast bailouts may encourage further folly, mainly by lenders.

For Wolf, the Asian crisis was not the result of economic basics (which were sound) but "partial integration into a world financial system unable to evaluate risk either intelligently or consistently." This exacerbated the ill effects of financial weaknesses, policy errors (adherence to fixed exchange rates) and turbulence abroad.

"Capital first flowed in on a flood tide, then poured out, leaving devastation in its wake."

Wolf attacks the IMF for imposing an unnecessarily severe economic squeeze. Since the illness is debt deflation, a slowdown must worsen the patient's condition.

"High real interest rates in heavily indebted economies are dangerous," writes Wolf. "For the IMF to treat deflation as if it were a traditional ill such as high inflation and fiscal profligacy is little more scientific than for a doctor to bleed his patients."

The IMF's Korea policies of raising interest rates, maintaining low inflation despite the depreciation and fiscal tightening would have this result: "However sick Korean companies and banks may now be, they will soon be sicker."

Wolf warns against further liberalisation of financial transactions, domestic and foreign. "Partial liberalisation of transactions within unreformed and undercapitalised financial systems has been at the root of the crisis. Any such combination is a recipe for disaster."

He thus criticises the IMF decision in Korea to open domestic money and bond markets to foreign investors as "highly questionable in current circumstances" and the elimination of restrictions on foreign borrowings by local firms as "dangerous."

IMF policies have also been attacked by analysts and economists in the affected countries. "Is the IMF doctor mistreating its Thai patient?" asks a front-page analysis in Thailand's daily, The Nation.

The authors, Vatchara Charoonsantikul and Thanong Khanthong, answer "yes." They say the IMF package for Thailand seeks only to cure the balance of payments crisis without addressing the financial crisis. Thus, Thailand is asked to tighten its fiscal and monetary policy, to raise interest rates and close down weak finance companies and banks.

"IMF officials believe once its prescription of an austere economic programme is followed strictly, confidence will return and capital will flow back...But this wishful thinking has not happened, with the country still paralysed by capital continuously flowing out of the system."

Interested only in nominal targets, the IMF is heartless in the consequences of its policy prescriptions, say the authors. It wants Thailand to stick strictly with high interest rates (to strengthen the baht) but "Thai financial institutions and corporates have been squeezed tighter as their access to capital has been cut off. Without capital, Thai business in general is heading for a breakdown. Good companies have turned bad and bad companies have grown worse."

Indonesian financial consultant, Steven Susanto, writing in the Far Eastern Economic Review (11 December 1997), criticised the IMF, World Bank and ADB for advising Indonesia to save itself by reining in inflation through contractionary policies that curtail economic activity.

"In truth the prescribed moves are unlikely to be effective in combating inflation and the continuing downward pressure on the rupiah. As such the result may be that the Indonesian economy will be doubly cursed with high unemployment and low rates of capacity utilisation."

The IMF programme in Indonesia needs two major revisions, says Susanto. Firstly, it should apply expansionary fiscal and monetary policies,

for example public investment to offset the ongoing economic contraction, and expansionary monetary policy to ease liquidity and lower interest rates.

Secondly, an income policy to resolve supply-side problems such as disparity in incomes, low domestic demand and low productivity. The focus should be to eliminate abnormal profit derived from the high prices set by producers and sellers.

The above survey of recent criticisms is a lesson not only for the affected countries but also for countries like Malaysia which are seeking to solve their own problems without resorting to IMF assistance.

For with its current process of exclusive decision-making by its staff, its susceptibility to influence by its major shareholders (the rich countries), the secrecy of its operations and, most frighteningly, the wrong policies making the situation worse, the IMF is bad news for any country needing its rescue.

Just as a patient can have his condition worsened, or even be killed, by a bad doctor or by the wrong medicine, a country whose finances have already been weakened by currency speculators and by investors fleeing on herd instinct, can have its economic prospects and long-term development crippled further by the IMF.

MARTIN KHOR is the Director of the Third World Network, whose International Secretariat is based at 228 Macalister Road, Penang, Malaysia. Tel: 60-4-2266159; Fax: 60-4-2264505; EMail: [twn@igc.apc.org](mailto:twn@igc.apc.org).

-----