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Understanding Pathways Through Financial Crises and the Impact of the IMF: An Introduction

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The International Monetary Fund is often perceived as imposing harsh policies on countries facing financial crisis. A comparison of six countries affected by the pressures of the 1990s suggests more subtle effects. In Malaysia, India, and South Africa, policymakers kept the IMF at arms length to permit a more gradual and heterodox adjustment, including capital controls in India and Malaysia. By contrast, Argentina, Turkey, and Indonesia were bound tightly into the embrace of the IMF. However, this did not push policymakers to take tough decisions. Rather, IMF loans to Argentina and Turkey permitted policymakers to postpone difficult choices as both they and the IMF sought to protect previous policies and loans. In Indonesia, by contrast, borrowing from the IMF opened up a conduit for larger political pressures that brought down the Suharto regime. KEYWORDS: International Monetary Fund, financial crisis, conditionality, capital markets, policy space, emerging economies.

In 1997, a crash in the Thai baht triggered a financial crisis that rapidly spread across East Asia and beyond. Many countries were affected by the crisis—some immediately, others less directly—as the reversal in confidence in emerging markets spread across to other corners of the globe. It soon became apparent that the East Asian crisis had recalibrated the willingness of capital markets to invest in emerging markets. Following on from Mexico's December 1994 peso crisis, it was also clear that a new kind of financial crisis had been born.

The International Monetary Fund (IMF) was the first agency of international recourse in dealing with the new financial crises. Its officials found themselves working amid a sharp debate about the causes of financial crises and how best to manage them.[1] While some economists focused on international factors—including contagion, recession in major export markets, and capital account liberalization— others focused on domestic causes of each crisis, such as uneven deregulation of the financial sector, poor fiscal and/or monetary policy, artificially high interest rates, corruption, and misallocation of capital at the domestic level. Unsurprisingly (given the difference of views

among officials, economists, and political scientists), the IMF soon found itself criticized on several counts. Critics argued that the Fund helped cause the crisis by having pushed countries to liberalize their capital accounts too fast. Equally, they accused the Fund of paying insufficient attention to the poverty effects of the stabilization measures it advised and of overstepping its jurisdiction in applying deep structural conditionality.

In the aftermath of the 1990s crises, much rethinking and analysis has taken place. Various international commissions were immediately formed to consider how to reform the Fund.[2] IMF staff have actively researched and debated the advantages and disadvantages of capital account liberalization and the possible uses of capital controls, as well as the possibilities for a more formal mechanism for restructuring sovereign debt.[3] Others have debated the appropriate and most effective role the institution might play in resolving financial crises.[4]

This special issue does not revisit the economics of the financial crises of the late 1990s. Nor does it look at the long-run political impact of the crises. Rather, it is concerned with how the IMF's engagement with a country affects the agenda of policymakers managing a particular crisis as well as the process by which decisions are made.

The impact of the IMF can be viewed in several ways. An informed outsider arriving in a moment of crisis may perceive the Fund as injecting new ideas, new solutions, and better information into the policy process. Politically, this contribution favors "technocrats" within government and can marginalize local coalitions supporting alternative government policies. The IMF typically sees itself as stiffening the spine of policymakers, enabling them to seize the opportunity presented by a crisis so as to boldly reform. Critics interpret the same intervention as opportunistic—with the IMF seizing a country's moment of weakness to press a government to adopt an agenda formulated in Washington, D.C.

The case studies presented in this special issue examine these competing presumptions, tracing out the role the IMF played in widening or narrowing the policy debate; the choices policymakers made; and the ranking of priorities. The answers are different in each case. We seek to probe why.

At the country level, the financial crises of the late 1990s (obviously) did not affect all countries in the same way. In some countries, the financial crisis left a legacy of enduring social and political disruption, while in others the economy soon bounced back. In part, this was because government responses were different. Facing a crisis, some engaged immediately with the IMF. Others did not. Some countries endured a political crisis at the same time as a financial one. Others had relatively robust and capable institutions of government with which to manage the crisis. Some had longstanding relationships with the IMF. Others had integrated into global financial and capital markets at their own speed and in their own way.

In each case examined in this special issue, researchers have attempted to get as close as possible to the decisionmaking process. They were greatly assisted by the cooperation of senior officials within each country and from a workshop held in Oxford in 2004 attended by Kemal Dervis (former finance minister of Turkey), Shankar Acharya (former chief economic adviser to India), Mario Blejer (former central bank governor of Argentina), Sergei Dubinin (former central bank governor of Russia), Gill Marcus (former deputy finance minister and deputy central bank governor of South Africa), and Rizal Ramli (former coordinating minister for finance and economy of Indonesia).

This framework paper sets out the initial hypotheses about the impact of the IMF on the policy choices made by governments, highlighting the potential sources of bargaining power and leverage enjoyed by the IMF, as well as the limitations on the institution's influence. It then outlines the six cases, noting their similarities and differences, and reports back some of the comments made on the studies by senior finance officials involved in each case, before offering some conclusions.

The Role of the IMF in Financial Crises

Countries facing a financial crisis soon find that commercial creditors desert them. Typically they approach the IMF as a last resort when they have little access to alternative sources of finance.[5] IMF assistance comes with many strings attached, including both formal conditionality and informal pressures and influences over the design, implementation, and procurement within programs and projects. The approval and support of the IMF tends to be a necessary prerequisite for most other forms of official assistance.

For the IMF and its powerful government members, engagement with a debtor opens up several channels of influence. The IMF can refuse to lend to the country, thereby depriving a government of the emergency resources it seeks. Furthermore, when the Fund turns down a request for assistance, the action may carry a second kind of penalty. In the absence of IMF willingness to intervene, other lenders and private creditors may refuse. More broadly, a refusal to lend may be interpreted by investors as a statement that a government's economic policies and prospects are not sound, although, as the discussion will show, the view that IMF's approval catalyzes private flows is much debated. The conditionality accompanying any loan involves some formal and some less formal requirements across a spectrum from "hard" to "soft." Hard conditionality describes measures a country must meet in order to access any money. Typically this involves "prior actions" and "performance criteria," which are specified in the formal agreement. These can be waived where minor deviations from agreed targets are considered to

be of a temporary or reversible nature. Soft conditionality refers to a wide range of other elements that the Fund will take into account in deciding whether or not to "complete" the reviews that are necessary to permit the disbursement of each portion of the loan. Such soft conditionality includes such things as structural benchmarks, indicative triggers, and general undertakings in the government's Letter of Intent.

Once an agreement is reached, the IMF has formal powers to monitor its lending and to apply sanctions if necessary on borrowers. If a government falls behind in implementing its agreed-on program, the institution can suspend or cancel its disbursements. More serious sanctions can be imposed on a government if it falls behind in its repayments, as governed by the IMF's arrears policy. Further to this, until the early 1990s, the IMF would withhold funding if a government fell behind on its wider repayment obligations to the private sector.

The power of the IMF to require a government to reform is significant. This is not because the institution necessarily provides a large amount of funding, but rather because it is in a position to provide resources rapidly at moments when no other institutions will. It is also because of the technical weight of what the IMF produces. The detailed program prepared by the IMF and backed by a technical rationale produced at the institution's headquarters in Washington is—for some governments—difficult to match or counter with an alternative. This is particularly the case where a country's own economic team does not have matching technical competence, or political skills, unity, and determination to take on the IMF. That said, it is easy to overstate the IMF's influence.

There are several constraints on the IMF's influence. The imprimatur of the institutions is always cited by policymakers and commentators as an important signal to private investors, although in fact the evidence of the catalytic effect of IMF agreements is ambiguous at best.[6] That said, the studies in this special issue suggest that a cruder form of market signal can work. Simply by appointing technocrats whom the markets trust and who are likely to have good relations with the IMF, several governments seemed to enjoy a short-term reprieve, such as in Argentina when Domingo Cavallo was reappointed, or in Turkey when Kemal Dervis was called into service, or in South Africa when an early decision was made to leave in post several technocrats from the previous regime's finance team. By contrast, in the case of Indonesia, the appointment of the former IMF deputy managing director, Prabhakar Narvekar, as a chief interlocutor with the IMF had little effect, since it was made simultaneously with President Suharto's launching of a "guerrilla war" on the organization.

The IMF's conditionality is also constrained in its effects. Available evidence suggests that the goals of conditionality are seldom achieved.[7] To set and monitor conditionality effectively, the institution depends on access

and information provided by borrowing governments. To enforce conditionality, the IMF relies heavily on the support of its major shareholders and their upholding of the terms and conditions of any loan. Where they choose to override the institution's approach to any country, the staff of the institution is left with very little leverage, as was amply displayed in the IMF's attempts to work with Russia throughout the 1990s.[8]

The political landscape within debtors is a further source of limitation on the IMF's influence. Political scientists have examined the impact of a number of political institutions on IMF programs. From that literature, we can extract two particular sets of factors: the institutional structures that either vest (or do not vest) authority in those negotiating with the IMF; and the number of actors, parties, and institutions participating in the policy process.

The authority of those with whom the IMF negotiates is crucial. Where an economy minister or central bank governor has considerable power over the agenda and process within domestic politics and is sympathetic to the IMF's agenda, obviously the Fund can enjoy considerable influence. This can occur as a result of an economic crisis where the crisis results in an expansion of executive authority.[9] Equally, a technocratic elite can maintain authority through institutional arrangements, such as through central bank independence[10] or through centralized budgetary processes.[11] Under some conditions, engagement with the IMF can be useful for policymakers wishing to undertake unpopular decisions.[12] Furthermore, there is some evidence that a government facing an election is unlikely to initiate a program with the IMF within six months before the election, and more likely to enter into an agreement with the IMF after the elections are over.[13]

Participation in the process of policymaking is equally important to the IMF's influence or lack thereof. Where there are veto players who can block a policy, obviously it will be more difficult for the IMF's interlocutors to implement their agenda.[14] In many cases, parliaments have refused to implement conditions attached to IMF loans. For example, in Russia in July 1998, the parliament flatly rejected a number of the tax reforms that were key conditions of an IMF loan that had been approved a day before. In Argentina in December 2001, the government's agreement with the IMF was soon flouted by the parliament. In Turkey in 1998, the parliament forced the government to break its promise to the IMF to hold down the wage increases of public sector workers. In Indonesia in 2002, the parliament decreed that the government should not extend its then current IMF program.

A further limitation is imposed where a large number of political parties within a political system produce "fragmentation." Forging agreement among a large number of parties is difficult and is further compounded when the system is strongly polarized, meaning that strong ideological differences drive actors in the system strongly to differentiate themselves, as occurred in Russia and in Turkey in the late 1980s.[15] In coalition governments (as the

Turkey case in this issue highlights), there is little or no incentive for all governing parties collectively to take responsibility for unpopular policies.

Diving into the structures within parties, political scientists have highlighted the impacts of electoral systems that encourage politicians to seek publicity and popularity for themselves with little need for party backing or support. This makes top-down economic reform (of the kind the IMF can most influence) difficult. For example, in open list systems, political parties do not control who gets to run for election, and in multiple-member constituencies, politicians have an incentive to appeal to selective parts rather than to the electorate as a whole.[16] These systems contrast with single-member constituencies in a closed list system, where politicians must tow the party line and face less incentive to cater to special interests.[17]

In this special issue, we do not replicate the existing work of political scientists and economists who have examined the relationship between formal attributes of political systems and IMF program compliance. Rather, we examine qualitatively the way a country's relationship with the IMF affects the diagnosis of the problem within the country, the prescriptions for dealing with it, and the implementation of policies in response to a crisis.

Four kinds of impacts the IMF can have emerged from discussions of the cases. First, the involvement of the IMF can *put new policies on the table* for a government in crisis. It may inject a different understanding of the problems faced. Negotiations with the IMF, as well as the IMF's technical work, may push items onto the agenda (for debate) that may previously have been taboo—such as structural reforms or privatization. By engaging with officials in government, the IMF can inform, persuade, or help bolster support for new measures, not least because access to IMF resources can be contingent on carrying out such measures. However, adding new items to the policy agenda can all too quickly become a "narrowing" where the IMF's hand is strong.

Engaging with the IMF in a crisis can *narrow participation in the policy debate.* The priorities that the IMF brings to the table are themselves narrow—focusing on stabilization rather than on equity, and on fiscal and capital account balance rather than on other factors influencing growth. At a political level, the IMF engages primarily with the finance ministry and/or central bank. This engagement can empower officials in those agencies, marginalizing others. The effect can be to forestall fuller debate about economic policy, tapering the priorities of the government to those of the finance ministry and central bank. Moreover, the debate itself can become overly polarized into a pro-IMF-reform and anti-IMF-reform battle, edging out other more mixed or nuanced approaches.

Third, the involvement of the IMF can be *permissive in postponing necessary policies,* providing the funding, the signals of confidence to the markets (whether effective or not), and the stamp of approval for policies

that fail to address the problem and instead postpone the day of reckoning. For politicians, there are obvious temptations to put off unpopular measures, particularly if an election is looming. For the IMF, there are more bureaucratic reasons for providing grounds to a government to postpone tough decisions. These include the IMF's need to maintain relations with a borrowing government, to protect its resources already deployed in a country, to justify previous policies and advice, and to cede to the preferences of major shareholders. These pressures lead to lending that results in losses some describe as harsher, more sustained, and less fair than the market.[18]

A fourth impact of engagement with the IMF can be to provide a *conduit for other political pressures.* This is highlighted in countries' arguments as to why they chose not to engage with the IMF. In contemporary East Asia, for example, avoiding IMF engagement is seen as a way of avoiding additional US pressures and special interests. Similarly, in countries as diverse as Russia, India, and South Africa, the argument equating IMF engagement with US influence has been made, and not without reason. In Indonesia, in the last stages of the Suharto regime, the IMF was deployed as part of an international strategy to withdraw support and foster political change. In Russia earlier in the 1990s, the IMF's work was pushed and pulled throughout the 1996 Russian presidential election to reflect G7 concerns about the election outcome.[19]

Six Financial Crises and Engagements with the IMF

Six cases are examined in this special issue: Indonesia, India, South Africa, Turkey, Argentina, and Malaysia. These are all "emerging economies" that, with the exception of Argentina, face considerable human development challenges.[20]

Although every country faced a financial crisis, not all engaged directly with the IMF. For some analysts, this is simply an a priori indication of the severity of each crisis. However, our case studies highlight that the severity of crisis depended heavily on the vulnerability of each country's banking and financial system to rapid swings in global capital markets and investor confidence, which in several cases was affected by prior engagement with the IMF. The three countries in this study that turned to the IMF—Argentina, Turkey, and Indonesia—had all previously liberalized under the close tutelage of the IMF and World Bank. Argentina and Turkey are both "prolonged users" of IMF resources, having spent seven or more years in a ten-year period under an IMF-supported program.[21] Indonesia had a similarly long and close relationship with the World Bank.

Long-standing loans from the IMF and World Bank have not only affected the pace and type of liberalization in each country but also given

a strong incentive to the IMF and World Bank to continue to support policymakers in these countries—to protect both their own material commitments and their prior policy advice. The cases highlight that under some conditions, this confers on the IMF an effect that is both constraining and permissive. It constrains the policy agenda—setting as the goal a single (rapid) speed of reform—and permissive in that at key moments there is a strong incentive to provide resources and support for putting off tough choices.

Malaysia, India, and South Africa all abjured from an IMF program even though each pursued a fairly orthodox set of stabilization and adjustment measures for a short period after the crisis. In each of these countries, the decision not to stay in an IMF program was driven by the desire to set their own pace of adjustment and to liberalize and reform more gradually than an IMF program would allow. A brief overview of the cases is given below.

Indonesia

Indonesia has had an oscillating relationship with the IMF throughout the recent period. From the early 1970s through the late 1990s, although the country had a strong relationship with the World Bank, it was, to quote Leonardo Martinez's study, "allergic to IMF standbys," choosing instead to deal with severe fiscal shocks in the 1980s using homemade programs. This changed in the late 1990s when rapid financial deregulation, coupled with weak regulatory institutions and corporate structures that encouraged excessive risk taking, rendered the Indonesia economy highly vulnerable to interest rate and exchange rate shocks.

The 1997 crisis began as an exchange rate crisis when the Bank of Indonesia's attempt to defend the currency failed and quickly spiraled into a banking crisis. In 1997, an IMF standby arrangement was agreed upon and a subsequent succession of agreements stayed in force for six turbulent years. The government floated the rupiah, turned to the IMF for assistance, and closed a small number of banks.

Indonesia's choices were shaped by heavy political pressures as well as specific economic constraints. The government needed to stabilize the currency because the corporate sector was highly exposed to foreign exchange risk, although there was inadequate information about foreign currency liabilities. An IMF loan was needed, but it came with extensive stabilization and structural reform conditions. The United States and the IMF opposed any blanket depositor guarantee to undergird selective banking closures. At the same time, there were mounting international pressures on the Suharto regime, including suspensions and cancellations of loans from the IMF, the World Bank, and the Asian Development Bank.

When the IMF stepped in, it exacerbated the crisis for Rizal Ramli, former Indonesian finance minister. The Fund was lured into giving detailed

advice, with too simplistic a view of "good guys" and "bad guys" and too much emphasis on technocratic economics. Its push for an increase in gasoline prices in 1997 provoked riots, which in turn led to the collapse in the confidence of investors. The currency depreciation wildly overshot that of comparator countries. The IMF-sponsored program of bank capitalization turned out to be the most expensive in the world.

The record suggests that in Indonesia's first two agreements with the IMF (in October 1997 and January 1998), the institution seized the opportunity to "set things right" in the country. Conditionality extended to banking; monopolies in cloves and plywood; trade barriers on wheat flour, soybeans, and garlic; the suspension of large infrastructure projects; and the opening of previously closed sectors, such as banking, to foreign investment. At first, Suharto's reaction was a nationalist one—he replaced his technocrats with nationalists and the IMF found itself cut off at the knees. However, the more direct coercive pressure exercised not just by the IMF's managing director but by other interventions, including that of the US president, led to the fall of Suharto's regime. The economic consequences of the crisis were equally profound. There was a serious contraction in the economy, particularly in the nonexporting, urban, formal sector. The poor and the middle class bore the brunt of the crisis, and while the government became heavily indebted, the corporate sector and bank owners largely managed to retain their assets.

India

In India, the crisis of 1997 had surprisingly little effect. The government had already experienced a classic external payments crisis in 1991, which had led to a series of reforms. That said, in both 1991 and in 1997, what made India different was its relatively lower vulnerability to outside pressures as compared with other countries. In 1991, this was due to the absence of private sector external debt, since individuals and firms could not raise foreign currency–denominated debt and the banking sector was not allowed to hold financial assets abroad. In 1997, even after liberalizing reforms, India still had much lower external debt (around 25 percent of GDP) than other countries (e.g, Indonesia's was 61 percent) and a predominantly state-owned banking sector in which nonperforming loans were only 8 percent of the total.

The IMF's role in India's reforms was very limited. Former chief economic adviser Shankar Acharya noted that India's relationship with the IMF had always been "good but shallow." India has withstood IMF fashions, such as the enthusiasm to push rapid capital account convertibility and to shift away from actively managing the exchange rate to limit inflation. India's insulation from these fashions is due, at least in part, to the fact that India's external resources have always been diversified. When the country

approached the IMF, it also limited the institution's influence. In 1991, this was by borrowing from the IMF's Compensatory and Contingency Financing Faculty rather than from a more heavily conditionality-laden standby. In 1993, this was by disengaging from the IMF so as to hold off demands that the government felt could threaten equity and political stability.

One effect of India's arms-length relationship with the IMF seems to have been a greater degree of "ownership" and gradualism than in other cases. Although devaluation in 1991 was undertaken alongside an IMF program, the content of that program was by all accounts mainly written by Indian officials within India. The government phased in a liberalization of the exchange rate, also building up greater independence of the Reserve Bank of India and enlarging its powers, but without embracing full independence. Capital flows were gradually liberalized alongside a careful and limited lifting of capital controls. Modest reforms were undertaken in the banking system, but it remained largely in government control. Foreign investment was encouraged by opening up the equity market to portfolio investments. An External Debt Management Unit was created, foreign exchange reserves were built up, new government bonds were issued to Non-Resident Indians, and foreign currency transactions were published (conforming to the IMF's Special Data Dissemination Standards).

Finally, India's engagements with the IMF were undertaken by highly respected and experienced Indian interlocutors. That said, their capacity to "politely ignore" the IMF was bolstered by India's relative lack of vulnerability to private external debt, as well as by their own capacity to make, plan, and justify policy.

South Africa

Like India, South Africa weathered the storm of 1997 at least in part because of its earlier responses to financial shocks. South Africa had defaulted in 1985 during the apartheid regime, triggering an escalating set of financial sanctions that cut it off from global capital markets. A four-year recession that began in 1989 was capped off by serious capital flight prior to the end of apartheid and the installation of the Mandela administration. The post-apartheid government that took office in 1994 faced not only a huge deficit but also a crisis in social services and in infrastructure due to a chronic lack of investment.

South Africa's new government did not borrow from the IMF. Until 1984, the country was the second largest African borrower from the IMF. The institution had agreed loans in 1982 and 1992, which were highly controversial since critics depicted them as a breach of international sanctions against the apartheid regime. Perhaps unsurprisingly, the first postapartheid government, having fought hard for sovereignty, was unwilling to cede influence to

the IMF or any external creditor, and especially not one accused of having supported the apartheid regime. Instead, the government adopted its own program of adjustment and development.

The challenges for the new government were clearly echoed in comments by Gill Marcus, who as deputy finance minister had played a key role in building the new institutions before shifting to become deputy central bank governor. During the 2004 discussion of the cases in this special issue, she noted that South Africa's postapartheid government had a difficult economic road to tread. Defaulting on "apartheid era debt" was out of the question, since much of that debt was owed to the public service whose pension funds had been invested in government stock. Equally, a closer relationship with the IMF would have had deep consequences: "I have absolutely no doubt that had we had to go to the IMF, our democratization process would be very different."[22] In her experience of the government's later relations with the IMF (participating in the Financial Sector Assessment Programme), the usefulness of the relationship was limited by the "extremely prescriptive" approach of IMF staff, who left little room for South African officials to set the agenda.

South Africa's homegrown agenda included a program of reconstruction and development within a fiscal limit (which critics subsequently argued was far too tight). At the same time, the government attempted to attract foreign investment by liberalizing trade, acquiring a credit rating, and reforming institutions, including the central bank and the federal fiscal management system. South Africa's pathway was underpinned by a determination not to rely on external debt, which proved an invaluable insulation against the storms of financial crises elsewhere after 1997.

Turkey

In Turkey, the reverberations of the 1997 crisis in East Asia were immediately felt, but financial crisis did not hit until 1999, as a result of both crisis in Russia and some poor underlying policies and structures within the Turkish economy. The IMF had been approached in the second half of 1997, presaging a program announced in June 1998. When Russia's August 1998 crisis hit Turkey, a further IMF program was agreed on in August 1999 but failed to forestall the oncoming crisis, which finally hit in February 2001.

Turkey's 1998 program with the IMF was marked by an innovative exchange rate–based stabilization anchor. This arose rather as an exception to usual IMF practice. In part this was because there was more time (than in an immediate crisis) to develop the policy. Yet, more significantly, the United States had strong interests in the arrangement, and there was a coalition of forces within Turkish politics prepared to push the arrangement. That said, once the overall IMF loan was approved, there remained little

incentive for members of Turkey's coalition government to explain or justify unpopular measures included in the package.

By 2000, Turkey's pegged exchange rate had become unsustainable. Somewhat disastrously, and with IMF support, the government attempted to shore it up until finally they were forced to abandon the peg in February 2001. The permissive support of the IMF reflected both the stake (in terms of advice and resources) the institution had in Turkey's existing arrangements and the significant pressure from the United States, which was concerned about fallout in its relations with a key strategic ally.

The 2001 crisis brought in a new economic team, headed by Kemal Dervis, which immediately had to weigh the costs of default against the costs of another program with the IMF. Default would be difficult because of the domestic holders of the debt. However, an IMF program also had costs, because the institution was disliked and distrusted by Turkish people, who rated it well below the UN (even at the time, the UN was perceived as having been overly pushy over Cyprus) and below the European Union (EU), even at the time the EU was refusing Turkey entry and providing no money.

In spite of anti-IMF feelings, a new program was soon negotiated with the IMF. In several ways it maximized the advantages of the new technocratic strength of the Turkish team. However, the political fallout was powerful. A year later, elections rejected the coalition government in favor of one led by the anti-IMF Justice and Development Party. That said, the new anti-IMF government remained within an IMF program and negotiated a new standby in 2005.

Argentina

Argentina is one of the IMF's most prolonged users of resources, having been in an IMF program for the full decade prior to the crisis, which began in 1999. During the period 1999–2001, a recession was followed by an external sovereign debt crisis and a domestic banking crisis. The country found itself on a downward spiral requiring tough decisions. The government turned repeatedly to the IMF for assistance. But this did not stave off the eventual crisis. Indeed, not unlike Turkey, the IMF's interventions in Argentina seem to have permitted tough policy choices to be postponed.

It was not until the end of 2001 that Argentina finally agreed to devalue the peso and default on its external debt. The consequences were immediate and far-reaching. International creditors obviously paid an immediate price. So too did most Argentineans as unemployment soared and urban poverty rates rose dramatically. As former central bank governor Mario Blejer put it, the shock for a country that had seen little poverty (around 9 percent in the 1980s) was that 54 percent of the population was estimated to be in poverty in 2002, some 21 percent of whom were in extreme poverty.

In a reverse logic to that of South Africa post-1994, external financing was crucial to Argentina's success. It was the key to the economy ministry's power in domestic politics and crucial in averting the triggering of the currency board's automatic adjustment mechanism. Paradoxically, to attract external financing, the economy ministry needed to sell Argentina as a model of financial prudence and then use the money to spend its way to domestic popularity. The IMF's role in this was complex. Having been in a tight relationship with Argentina since the early 1980s, the institution had invested both its advice and resources in the country, making the withdrawal of either extremely difficult.

Malaysia

In Malaysia, the 1990s financial pressures had rather different effects. Faced with the fallout of the crisis in Thailand, Prime Minister Mahathir responded at first with a nationalist reassertion of control. This was soon followed by some conventional stabilization measures, including raising the central bank rate, reducing government expenditure, and tightening banking supervision. However, when these measures deepened the recession caused by the crisis, the government opted instead for a pegged exchange rate and capital controls. These mitigated the social and political impacts of the crisis.

Malaysia chose not to borrow from the IMF in part because it did not need an emergency credit facility—the country's foreign liabilities did not exceed its foreign exchange reserves. Furthermore, it had not borrowed from the IMF since the early 1980s. Although the government implemented its own IMF-style structural adjustment program in the wake of the crisis, this soon gave way to a more gradualist approach, which eased the impact on the economy.

Although Malaysia was vulnerable to some contagion, these effects were dampened by the use of capital controls in September 1998. Malaysia had also used capital controls in 1994 to good effect. Furthermore, like India, Malaysia's vulnerability was attenuated by limits on foreign borrowing and by prudential regulations and supervision that had been constructed after that country's banking crisis in the late 1980s.

The Consequences of IMF Intervention

Several overarching themes emerge from the cases discussed in this special issue. Principal among them are reflections on the consequences of IMF engagement for politics and on broader outcomes within countries. Four reflections in particular stand out.

First, loans from the IMF can entrench short-term goals and priorities into decisionmaking. Of course, it is true that in a financial crisis the markets impose an immediate set of goals on a government (depending on the country's vulnerability to the markets). However, engagement with the IMF adds further structural reasons for short-term goals to be prioritized. Most of all, the institution has time-limited instruments—its core instrument is a one-year standby, which means that conditions must be delivered upon within that time frame. Yet, as South African official Gill Marcus put it, it took South Africa three years to make headway on revenue collection (a time frame made possible by the assistance of Sweden as a bilateral donor). In Turkey, Kemal Dervis noted that speed eroded quality when it came to policy and that although in some areas the IMF usefully strengthened the government's hand, in others it required change at a speed that made good quality policy difficult. It was for this reason that India backed out of its engagement with the IMF.

A second impact of an IMF loan in a crisis is that it engages the IMF in a way that forestalls coordination and "ownership" of economic strategy within government. For an IMF mission team, the imperative is to reach a deal in a short period of time—two weeks in some of the cases in this special issue. In countries with poor policy coordination mechanisms, this gives no time for coordination or collation of information or policy across ministries. It has been argued by others that this is a positive effect, since it permits technocrats to undertake reforms without giving time for vested interests to organize opposition to them.[23] However, the senior officials engaged in this project spoke of the costs of forging economic programs with the IMF without adequate information from other parts of government about how best to mitigate the harsh effects of a program. As former South African official Gill Marcus noted, all governments have problems with coordination, but the only ones likely to be able to coordinate in a moment of crisis are those with preexisting institutionally compelling arrangements. Certainly in India, as former official Shankar Acharya noted, coordination within the Indian government was limited but effective. The IMF dealt with the finance ministry, the prime minister's office, and the central bank, which itself reported to the finance ministry. Coordination among these agencies was close, even if other parts of the government felt unconsulted and left out of the process.

A third aspect of engagement with the IMF that emerges strongly from the cases in this study is the underlying high-level political relationships that affect the IMF's leverage as well as that of a borrowing government. As one official put it, IMF staff could always be sidelined by appeals over their heads. In the memorable words of a former Argentine president dismissing the need to speak with an IMF mission, "If you can't talk to the owner of the circus, why talk to the monkeys? . . . It was easier and more pleasant to speak directly to the US capital than with the Fund officials."[24]

In Argentina at that time, if conversations with Alan Greenspan or the like could not resolve an issue, President Menem would call President Clinton. This high-level contact remained true in Argentina into early August 2003, when careful tough technical negotiations were pushed aside by a front-page photo of Finance Minister Lavagna with Greenspan. IMF and US Treasury staff were left with little leverage when this was coupled with intimations by the US assistant secretary of state that the IMF should lay off Argentina.

Finally, an issue that underpinned all responses to the financial crises was the likely domestic political fallout. For example, on the issue of whether or not to default on existing debt, the key question was who would lose the most from such a default. The composition of debt, the support of international actors in respect of their policies, and their own reputation and tradition with respect to debt each played a role. In 2001, Argentina very publicly defaulted on debt to foreigners. In part, this may have been because the president had not fully understood the composition of that debt. In practice, the default on foreign debt was never as simple as it may have seemed, not least because so many Argentines owned international bonds. Hence, some 45 percent of that debt on which the government defaulted was in fact owned by Argentine citizens and companies. In Turkey, the new economic team decided that they could not default on Turkey's debt because so much of it was owned by Turkish entities. As already mentioned, defaulting on "apartheid debt" in South Africa was unthinkable because it was owed to the public service, since pension funds had to invest in government stock. In India, policy was shaped by the fact that external debt was relatively small and Indian policymakers feel committed to a tradition of never defaulting on treaty obligations.

More broadly on the issue of political fallout, those governments that borrowed from the IMF paid the largest political price—both in terms of regime change or electoral consequences and in terms of deeper social and economic outcomes. Countries that used IMF resources had to very rapidly formulate policies likely to win the approval of the IMF's management and board. These policies shared a profile of immediate (and some would say draconian) cuts in government and social spending. Countries that did not rely on IMF assistance maintained more heterodox policies—and this shows up in their relatively unperturbed levels of social spending.

In each of the cases in this special issue, the pressures of the 1990s brought about social and economic dislocation. Typically, there were increases in unemployment, greater activity in the informal economy, and a drop in real wage levels, albeit with differences across sectors. Poverty and inequality levels rose depending on the status of safety nets and social provision, and access to health and education dropped. Unfortunately, there is no single, comparable source for evaluating these effects, although we attempt some rough estimates below.

The gap in data itself is worthy of comment. Neither the IMF nor the World Bank has readily available data on the social effects of financial crises. We have examined and used macroeconomic indicators from IMF program documents and country reports wherever possible, but these are limited. More direct welfare indicators that more accurately capture the social effects of the crisis are difficult to find. The World Bank Development Indicators database (on the World Bank website) purports to be the most comprehensive source for this information. However, we found that data are missing for many of the indicators and years needed. Country data show annual changes at the country level but do not disaggregate by sector or location (urban, rural). Additional information on welfare could be gleaned from the World Health Organization (WHO) database, which reports mortality rates by age group (limited to specific years 2000 and 2003), and the WHO World Health Reports and UNESCO Education for All reports, which provide data on health and education expenditure, respectively. However, there are significant gaps in the data sets, particularly for years prior to 1997.

From the data we collected, several features stand out. Argentina, Indonesia, and Turkey all faced a collapse in GDP of around 10% or more.[25] Yet the patterns of expenditure in each of these IMF program countries were different through the crisis. In Argentina, where an already falling GDP collapsed by 10.9% in 2002, government expenditure fell as a proportion of GDP from 29.6% in 2001 to 24.4% in 2004, and expenditure on health and education remained the same percentage of GDP (meaning that it decreased by the same amount as GDP).[26] In Turkey, where an already falling (albeit fluctuating) GDP fell by 9.5% in 2001, government expenditure stayed constant, as did expenditure on health and education as a proportion of GDP. In Indonesia, where GDP collapsed by 13.6% in 1998 but began to recover in small steps thereafter, government expenditure rose as a proportion of GDP from 17.2% in 1998 to 24.5% in 2001, as did expenditure on health and education. These figures give us some sense of a range of outcomes even in countries most severely afflicted by financial crisis.

The larger gap lies between the countries with IMF programs and those without. In the latter, the macroeconomic effects of crisis were less severe but their social expenditure patterns are nevertheless very different. In Malaysia for example, when GDP dropped by 2.4% in 2001, government expenditure rose to 29.6% of GDP (from a level of around 22%), as did expenditure on health and education.

In South Africa (using South Africa's own statistics),[27] government expenditure had been rising prior to the 1997 crisis by 18.6% during the periods 1995–1996 and 1996–1997 with expenditure on education and health rising by 22.7% and 24.4%, respectively. In the year after the 1997 financial crisis, government expenditure increased by just 4.3%, with spending on education and health rising by merely 0.5% and 1.8%. However,

within a year, expenditure had rebounded with total government spending rising by 9.2% (by 1999–2000) and the following year by 9.4%, and expenditure on education and health rising by 9.2% and 16.2% in 2000–2001 and by 9.7% and 2.1% in 2001–2002, respectively.

In India (using India's own statistics in constant 1993–1994 prices),[28] we find a steadily increasing expenditure on health and education across the 1990s. Education expenditure increased by 21.07% in 1990–1991 and then by 30.39% in 1995–1996, 33.69% in 1997–1998, and 42.03% in 1998–1999. Health expenditure was already rising by 6.47% in 1990–1991, and rose by 9.88% in 1996–1997, by 10.59% in 1997–1998, and by 11.27% in 1998–1999. Not even a ripple is in evidence of the financial crises across the emerging markets of 1997.

These comparisons are rough and ready, giving little indication of the social distributional consequences of efforts to manage financial crises or their impact on poverty. On this, in the absence of better data, it is difficult to see how the IMF and World Bank can gauge the social effects of their interventions in the management of financial crises, either ex post or, as important, at the time of policy design.

Conclusion

In the early twenty-first century, the pathway a country takes through a financial crisis is undoubtedly affected by its relationship with the IMF. However, that relationship can have a number of different and intermingling effects.

In theory, the IMF's vast experience and technical expertise can inform and help a government analyze the problem and design an appropriate response. This "informing" effect seems most likely to occur when other more immediate pressures are at bay. For example, in 1997–1998, the IMF helped Turkey define an innovative exchange rate policy in part because there was time (a full-fledged crisis had not arrived), and in part because the United States—in the wake of the East Asian crisis—was putting more pressure on the IMF to reframe its more conventional approach. In India throughout the 1990s, policymakers saw the IMF as a useful sparring partner and provider of analytic advice, some of which they could politely ignore, because India could afford to step away from its loan from the IMF and pursue an alternative pathway.

More typically, the IMF has a narrowing effect on policy. This is partly because both time and the time frame of IMF loans are significant constraints. A quick loan requires quick approval from the senior management and board of the IMF. This is most likely to occur where a loan conforms to a preexisting template of conditions (as well as when the United States

engages directly). Further pressure results from the fact that a program must be designed to produce immediate effects in order to justify disbursement and the short-term nature of the instrument. The result of these pressures is often a fairly standardized set of stabilization and adjustment policies that leave little room for a government to adapt its management of a crisis to specific vulnerabilities in its economy and in its social and political systems. In subsequent time periods, the fact of a preexisting engagement with the IMF affects both the vulnerability of an economy (because it liberalizes faster than non-IMF program countries) and the likelihood of a permissive IMF program.

A permissive effect from engagement with the IMF emerges where the Fund has a stake to protect in a country and provides resources and a stamp of approval to policies that the government would not otherwise be able to sustain. In some cases, more money permits a government to postpone necessary reforms, with the result that the crisis deepens and the eventual cost of resolution grows. This occurred in both Turkey and Argentina.

In Indonesia, a different effect emerged. There, borrowing from the IMF quickly became a conduit for more powerful political pressures, which eventually brought down the Suharto regime. In South Africa and Malaysia, it was a desire to avoid any such direct kinds of pressure that played into the decision not to engage with the IMF.

In sum, the cases highlight several effects from engaging with the IMF during a financial crisis that have received little attention from scholars. First, loans from the IMF can have the perverse effect of entrenching short-term goals and priorities into decisionmaking. Second, amid a crisis the IMF is usually engaged in a way that forestalls coordination and "ownership" of economic strategy within government; the only governments likely to be able to coordinate in a moment of crisis are those with preexisting institutionally compelling arrangements. Third, the IMF's leverage as well as that of a borrowing government is always affected by underlying high-level political relationships: "If you can't talk to the owner of the circus, why talk to the monkeys?" Finally, although not analyzed by the IMF, a key criterion in each government's choice of a pathway through financial crisis was their appraisal of the likely domestic political fallout, including who would be the winners and losers from a default on existing debt. 🌐

Notes

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20. Their rankings in the Human Development Index are Argentina 34, Malaysia 61, Turkey 94, Indonesia 110, South Africa 120, and India 127; see *Human Development Report 2005* (New York: United Nations Development Programme).

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22. Comments made at workshop, “Pathways Through Financial Crises,” University College, Oxford University, 29–30 April 2004.

23. See, for example, Anne Krueger, “Maintaining the Momentum: Emerging Market Policy Reform in 2004,” keynote address at the Asia Society conference “Investing Across Emerging Markets 2004,” New York, 29 November 2003.

24. As recounted by Mario Blejer at workshop, “Pathways Through Financial Crises,” University College, Oxford University, 29–30 April 2004.

25. These figures (and all subsequent GDP and aggregate government expenditure figures, unless otherwise indicated) are drawn from the 2004 IMF Country Report for each country, available at www.imf.org.

26. These and all subsequent figures on government health expenditure (unless otherwise indicated) have been drawn from the 2004 and 2005 WHO World Health Reports, available at www.who.int/whr/2004/annex/topic/en/annex_5_en.pdf; and

www.who.int/whr/2005/annexes-en.pdf. Government expenditure on education in each case has been drawn (unless otherwise indicated) from www.uis.unesco.org/TEMPLATE/html/Exceltables/education/finance.xls.

27. Based on the statistics on the total consolidated expenditure by the general government sector for each financial year, provided by Statistics South Africa at www.statssa.gov.za.

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