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Working Paper

Pathways through financial crises: An overview

GEG Working Paper, No. 2004/01

Provided in Cooperation with:
University of Oxford, Global Economic Governance Programme (GEG)

Suggested Citation: Woods, Ngaire (2004) : Pathways through financial crises: An overview, GEG Working Paper, No. 2004/01, University of Oxford, Global Economic Governance Programme (GEG), Oxford

This Version is available at:
https://hdl.handle.net/10419/196266

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PATHWAYS THROUGH FINANCIAL CRISES - AN OVERVIEW

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10 May 2005

GEG WORKING PAPER 2004/01

UNIVERSITY COLLEGE OXFORD

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Introduction

In 1997 a crash in the Thai baht caused a financial crisis, which rapidly spread across East Asia and beyond. Many countries were affected by the crisis. Some immediately, and 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. A new kind of financial crisis had been borne.

The financial crises of the 1990s sparked debate about the causes of financial crises and how best to manage them.[1] The IMF soon found itself criticized on several counts. Critics argued that the IMF helped cause the crisis by having pushed countries to liberalize their capital account too fast. Subsequently, after the crisis, the IMF was accused of paying insufficient attention to the poverty effects of the stabilization measures it advised, and of having overstepped its jurisdiction in applying deep structural conditionality.

In the aftermath of the 1990s crises some degree of rethinking and analysis has taken place. Reforms to the governance of the IMF have been proposed by a slew of international commissions subsequently proposed various reforms (Bergsten et al 1999, CFR Independent Taskforce 1999, Meltzer Commission 2000, ICMB 1999 and 2004). Meanwhile economists have debated the appropriate and most effective role the institution might play in resolving financial crises (Fischer 1999, Bordo and Schwartz [], Eatwell and Taylor 1998).

Within the IMF staff have actively researched and debated the advantages and disadvantages of capital account liberalization and the possible uses of capital controls. Fund staff initially led the debate in how international mechanisms might be improved to ensure the orderly and symmetric working-out of financial crises (Krueger []). A Sovereign Debt Restructuring Mechanism was proposed, albeit soon quashed by powerful member states (Taylor []).

Several questions still remain. At the country level, the financial crises of the 1990s did not affect all countries in the same way. In part this was because governments responded to crises in different ways. 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. The result was that in some countries the financial crisis left a legacy of enduring social and political disruption, while in others the economy soon bounced back.

The cases in this special issue set out to explore why governments responded to the crisis in different ways. They focus on external constraints faced by governments and how relations with the IMF affected domestic choices and political institutions. In each case, key government decisions, including decisions taken before and after the crisis, are examined. Each author sets out to explain why a particular pathway was taken and with what consequences and for whom. The role of international actors is fed into an analysis of the autonomy of the economic team, the stability of the ruling coalition and its time horizon, federal/state control of the

budget, bureaucratic capacity, the role of the legislature, and business-government relations.

The researchers contributing to this issue have attempted to get as close as possible to the decision-making process. To this aim the research was greatly assisted by the cooperation of senior officials from each of the countries studied when fieldwork was undertaken. The papers have also benefited from a discussion of them held in Oxford in 2004 attended by the authors as well as by Kemal Dervis (former Finance Minister of Turkey), Shankar Acharya (formerly Chief Economic Adviser, India), Mario Blejer (formerly Central Bank Governor, Argentina), Sergei Dubinin (formerly Central Bank Governor, Russia), Gill Marcus (former Deputy Finance Minister and Deputy Central Bank Governor, South Africa), Rizal Ramli (formerly Coordinating Minister for Finance & Economy, 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 reporting back some of the comments made on the papers at a discussion among senior finance officials from each case country, held in Oxford in 2004.

Financial Crises, Policy Responses and the Role of the IMF

Facing a crisis, many countries fall into the embrace of the IMF and international creditors on whom they have come to depend. In this situation the IMF is armed with three instruments: lending, conditionality, and a gate-keeping role in respect of other official creditors. The impact of the IMF depends upon several factors, including the preferences of major shareholders in the institutions, pre-existing relations with the government in question, and that government's access to other resources.

Governments mostly approach the IMF when they have little access to alternative sources of finance.[2] This is because a loan from the Fund comes with many strings attached including both formal conditionality and informal pressures and influences over the design, implementation and procurement within programs and projects. No surprise then that South Korea was determined not to approach the IMF when it found itself in difficulty in 1997. It was only under strong US pressure that South Korea eventually agreed to meet with the IMF's most senior officials despatched to Seoul at the eleventh hour (Blustein 2001).

Once a country approaches the Fund, it opens up a number of opportunities for the institution and its most powerful government members to wield influence through penalties, conditionality, and advice. The IMF can refuse to lend to the country thereby depriving a country of the emergency resources sought. Furthermore, when the Fund turns down a request for assistance, the action carries a second kind of penalty. A refusal to lend will be interpreted by many other investors as an unwillingness to certify that a country's economic policies and prospects are sound. This can send a strong message to the markets and other potential lenders. Indeed,

some countries will seek a positive certification even in the absence of a loan in the hope that this will help to catalyse funds from elsewhere.

When a loan is made to a country it is accompanied by conditionality. In practice, this 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, which are necessary to permit the disbursement of each portion of the loan. Such soft conditionality includes things such as structural benchmarks, indicative triggers, and general undertakings in the country's letter of intent (IMF/IEO 2002, 59).

Once an agreement is reached, the IMF has formal powers to monitor its lending and to apply sanctions if necessary on borrowers. If a country falls behind in implementing its agreed programme, the institution can suspend or cancel its disbursements. More serious sanctions can be imposed on a country 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 from countries if they fell behind on their wider repayments 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 actors will. That said it is easy to overstate the IMF's influence. Policy-makers and commentators always cite the imprimatur of the institutions as an important signal to private investors, although in fact the evidence of the catalytic effect of IMF agreements is ambiguous at best (Mody and Saravia 2003, Cottarelli and Giannini 2002, Mosley 2000). Likewise, although the IMF imposes conditionality, available evidence suggests that its goals in this regard are seldom achieved (Killick 2002). Furthermore, effectively to set and monitor conditionality, the institution depends on access and information provided by borrowing governments. Most importantly of all, as a multilateral institution the IMF's influence depends heavily on the policies of its major shareholders. Where they chose to override the institution's approach to any country, the staff of the institution are left with very little, if any, leverage.

This study was sparked by an interest in the question of whether the involvement of the IMF widens or narrows the choices and priorities confronting a government. Emerging from the cases several important factors become apparent. The length of a country's relationship with the IMF can affect how the diagnosis and prescription for the crisis is undertaken within a country and the pre-existing strength and quality of that relationship will also affect the range of options. External constraints play a key role, such as the engagement of the United States and other G7 countries, as well as private investors. Finally, the process of economic policy-making within the government is crucial. For example, whether or not policy is centralized, and which institutions are most receptive to domestic creditors and investors, and to foreign creditors and investors, all come to the fore as important considerations.

We find at least three different kinds of impacts the IMF can have on government choices. First, the involvement of the IMF could open up more policy space for a government in crisis. It may help to open up a better understanding of the problems faced. Negotiations with the IMF, as well as the IMF's technical work may push items onto the agenda, which may previously have been taboo – such as structural reforms or privatization. Engagement with the IMF in this scenario helps to strengthen the hand of the Finance Ministry and/or Central Bank whom the IMF can persuade or help bolster in pushing for new measures, not least because access to IMF resources can be contingent on carrying out such measures.

On an alternative view, the IMF might narrow the policy agenda of governments. The priorities that the IMF brings to the table are themselves narrow – focusing on stabilization rather than equity, and on fiscal and capital account balance rather than other factors influencing growth. At a political level, the narrowing of the agenda could occur because the IMF works principally through (and thereby empowers) the Finance Ministry and Central Bank. In so doing, other agencies are disempowered.

A third scenario is that the involvement of the IMF opens up the realm of choices facing a government but in a negatively permissive way. On this view IMF lending permits a government to make decisions, which postpone the day of reckoning, passing at least some responsibility for the crisis forwards to another moment, and perhaps another government.

The Cases

The six cases analysed vary across several dimensions. Indonesia and Malaysia each suffered immediate effects of the 1997 crisis, with Indonesia entering into a programme with the IMF almost immediately. By contrast, Malaysia abjured from an IMF programme even whilst pursuing a fairly orthodox set of stabilization and adjustment measures for a short period after the crisis. India and South Africa were less directly affected by the 1997 crisis. In each of these countries financial vulnerability was managed through institutions and practices which had been developed earlier in the 1990s. Interestingly, although India undertook an IMF programme, in neither India nor South Africa do the country's choices seem to have been constrained by IMF programme prescriptions. By contrast in Turkey and Argentina the IMF played a central role, which was both constraining and permissive. These countries suffered in a later wave of emerging market financial crises.

Financial crisis emerged in each country from a set of pre-conditions. There has already been a prolific debate among economists and others as to which were the most significant. Some scholars argue that international pre-conditions and factors were the major cause of crisis, including contagion, recession in major export markets, and capital account liberalization caused countries such as Korea to endure a crisis (Wing Thye Woo et al 2000; Fattouh and Demetriades 1999). Other scholars focus 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 (IMF, IEO Evaluation Report 2003). The objective of this research is not to add to this debate. Rather, the intention is to examine and better the politics of choices made in managing each crisis.

In each of the cases, the financial crisis suffered is outlined along with the country's pre-existing relationship with the IMF. The authors then draw out three of four key decisions, which were made, including the decision to approach (or not) the IMF for assistance. The subsequent analysis identifies the constraints and permissive factors, which explain why a particular pathway was chosen and alternatives eschewed.

Indonesia was immediately and deeply affected by the crisis which began in Thailand in 1997. The financial crisis hit Indonesia amidst a serious concurrent political crisis. The government rapidly took three key decisions which shaped the impact of the crisis. It floated the rupiah rather than attempting to manage the currency. It turned to the IMF for assistance rather than imposing capital controls or attempting intervention by other means. Finally, the government opted to close a small number of banks rather than either opting to close all insolvent banks or delaying any closures by providing emergency liquidity.

Heavy political pressures as well as specific economic constraints shaped Indonesia's choices. The government was under increasing international pressure to step-down with suspensions and cancellations of loans from the IMF, the World Bank, and the Asian Development Bank becoming part of that concerted external pressure. Economically, there were also constraints. The government had to stabilize currency because the corporate sector was highly exposed to foreign exchange risk. There was inadequate information about foreign currency liabilities with the Bank of Indonesia having inadequate powers over reporting, and fears of foreign investor nervousness about being required to report. An IMF loan was needed but came with extensive stabilization and structural reform conditions. And finally, there was US and IMF opposition to any blanket depositor guarantee to undergird selective banking closures.

The impact of Indonesia's chosen pathways was a serious contraction in the economy and particularly in the non-exporting, urban, formal sector. The government became heavily indebted while the corporate sector and bank owners largely managed to retina their assets. A transfer took place from the state and general public to the corporate sector. The poor and middle-class bore the brunt of the crisis. However, in the end it was the political system itself which collapsed under the dual pressures of economic and political crisis.

For Rizal Ramli, former Indonesian Finance Minister, the IMF exacerbated the crisis. It 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 fed the collapse in confidence of investors. The currency depreciation wildly overshot that of comparator countries. The IMF-sponsored programme of bank capitalization turned out to be the most expensive in the world.

In India the crises of 1997 had surprisingly little effect. Crucially the country had already experienced a classic external payments crisis in 1991 which caused it to embark on a series of economic reforms. These reforms in turn helped the country weather the storm of 1997. Some key decisions in response to the earlier crisis particularly shaped the country's pathway through later turbulence. Devaluation in

1991 was undertaken alongside an IMF programme which, unlike most other countries' comprised conditionality mainly written by Indian officials within India. One major difference with typical IMF programmes concerned the timing and gradual phasing-in of change. The government phased-in a liberalization of the exchange rate, alongside the building-up of greater independence to the Reserve Bank of India. Capital flows were gradually liberalized alongside a careful and limited lifting of capital controls. Foreign investment was allowed in, but in a carefully managed way alongside reforms to the banking system.

Former Chief Economic Adviser Shankar Acharya noted at the Oxford meeting 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 from using the exchange rate as a nominal anchor to a bipolar system. India's insulation from these fashions is at least in part this is due to the fact that India does not have access to huge resources from the IMF. Its external resources have always been diversified.

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, which cut it off from global capital markets. A four-year recession, which began in 1989 was capped off by serious capital flight prior to the end of apartheid and the installation of the Mandela administration.

When the post-apartheid government took office in 1994, it faced not only a huge deficit but also a crisis in social services and in infrastructure due to a chronic lack of investment. The new government took three key decisions. It decided not to borrow from the IMF or World Bank, in spite of having a long-standing relationship with each institution and ready-access to resources. It adopted a far-reaching reconstruction and development programme embedded in the budget and in the institutions of government. Thirdly, the institutions for making economic policy were strengthened and reconfigured, including a more independent Central Bank, a new federal fiscal management system and a tripartite national economic development and labour council.

The challenges for the new government were clearly echoed in comments by Gill Marcus at the Oxford meeting. As Deputy Finance Minister she had played a key role in building the new institutions before shifting to become Deputy Central Bank Governor. South Africa's post-apartheid 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'. 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 Fund staff that left little room for South African officials to set the agenda.

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 both of 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 programme announced in June 1998. Russia's August 1998 crisis hit Turkey both directly and through a contagious lack of confidence which affected all emerging markets. A further IMF programme was agreed in August 1999 but failed to forestall the oncoming crisis, which finally hit in February 2001.

One of the Turkish government's first key decisions as it faced economic strain was the 1998 decision to use an exchange rate based stabilization anchor. Later, it would decide not to opt to float the currency but instead in 2000 to attempt to maintain the peg. Finally, in 2001 a new economic team implemented a different package of policies. However, the record post-crises reveal that the earlier decisions created a very costly pathway for Turkey with severe distributional and political consequences.

Kemal Dervis, the Finance Minister from 2001, noted in the meeting at Oxford that the first decision of the new team was to weigh up the costs of default against those of a programme with the IMF. Default would be difficult because of the domestic holders of the debt. However, a Fund programme also had costs. Indeed one legacy of the IMF's interventions in Turkey has been that even at the time of its jumbo package, the institution is disliked and distrusted by Turkish people who rated it well below the UN (even at the time hat institution was perceived as having been overly pushy over Cyprus) and below the European Union even at the time the EU was refusing entry and providing no money.

In Argentina a triple financial crisis struck in 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 to the IMF for assistance, not once but repeatedly. 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.

By the end of 2001 Argentina had finally 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 Argentinians as unemployment soared and urban poverty rates rose dramatically. As former Central Bank Governor Mario Blejer put it at the Oxford meeting, the shock for the country that had seen little poverty (around 9% in the 1980s) was that 54% of the population was estimated to be in poverty in 2002 some 21% of which were in extreme poverty.

In Malaysia the 1990s financial pressures had rather different effects. Faced with the fall-out of the crisis in Thailand, the government took a series of decisions including an initial reassertion of national control over economic policy-making, replaced by an orthodox package of policies which was subsequently reversed, and followed by the introduction of capital controls. Significantly for this study, Malaysia chose not to enter into a programme with the IMF.

The initial nationalist response by Prime Minister Mahathir was 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 yet it seems clear that Malaysia's policies would not have emerged from within a programme relationship with the IMF.

Timing, Coordination and Constraints

Several over-arching themes emerged from the discussions among key finance officials. Principal among them was the impact of IMF intervention. In explaining the intrusiveness of the IMF in Turkey, the former Finance Minister said that 'there was no question of having financing and doing your own programme' even if there was some leeway on some points. One key reason was timing.

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 study. In countries with poor policy coordination mechanisms, this gives no time for coordination or collation of information or policy across Ministries. This point was immediately recognized by Sergei Dubinin, former Central Bank Governor in Russia who highlighted how impossible it was to rapidly coordinate across the Ministries of Finance, Energy, Economy, and with the Deputy Prime Minister and the Central Bank. To make matter more complicated in Russia's negotiations with the IMF, the Fund insisted on the coordination of policy with the Parliament.

The politics of coordination are always complex, as South African former official Gill Marcus noted - all governments have problems with coordination. However, if a government is trying to coordinate in a moment of crisis then it is simply too late. Governments need ready-existing institutionally compelling arrangements which set out the form interactions among agencies will take. And this was the experience of Argentina and India.

A long-standing relationship with the IMF existed with Argentina meaning that there was a pattern of coordination led by the Ministry of Finance already well established. As described by former Central Bank Governor Mario Blejer, conflicts were resolved by the President, and Parliament was consulted merely as a public relations exercise. Crucially, the IMF staff could always be sidelined by appeals over their heads. As one Argentine President put it prior to negotiations with the IMF: `if you can't talk to the owner of the circus, why talk to the monkeys'? `It was easier and more pleasant to speak with Alan Greenspan than with the Fund officials'. And if this did not resolve an issue, President Menem would call President Clinton. This remained true in Argentina through into early August 2003 when careful tough technical negotiations were pushed aside by a front-page photo of Finance Minister Lavagna with Alan 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.

A long-standing relationship with the IMF also characterized India whose government also dealt with the IMF at management level rather than through staff

missions. As former official Shankar Acharya noted, coordination within the Indian government was always very 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. However, other parts of the government certainly tend to feel unconsulted and left out of such a process.

The IMF has time-limited instruments – its core instrument is a one year standby which means that conditions must be delivered on within that time frame. Yet the kinds of reform, which it has come to recognize as vital take much longer to achieve. As South African official Gill Marcus put it, reform takes a long time. It took South Africa three years to enhance revenue collection (with the assistance of Sweden as a bilateral donor). So too in Russia Sergei Dubinin, the former Central Bank Governor, noted that whilst the IMF wanted immediate progress on tax collection, it took two years just to establish the administration necessary to start the process, and some ten years for that process to deliver results for tax evasion had been thoroughly widespread. In Turkey Kemal Dervis noted that speed mitigated against quality when it came to policy. Although in some areas the IMF usefully strengthened the government's hand, on others, it required change at a speed which mitigated against good quality policy.

Finally, an issue, which underpinned every government's decision about whether or not to default on existing debt, was the composition of that debt, and the support of international actors in respect of their policies, and their own reputation and tradition in respect of debt. 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% 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 mentioned above, in South Africa defaulting on `apartheid debt' was unthinkable because it was owed to the public service because pension funds had to invest in government stock. In India, policy was shaped by the fact that external debt was relatively small and Indian policy-makers feel committed to a tradition of never defaulting on treaty obligations.

In conclusion, the IMF's assistance and advice did not have the same impact on all countries. That said, we have deliberately included in this study countries which were affected by the crises of the late 1990s but which did not seek an arrangement with the IMF. Their inclusion reveals the extent to which countries which used IMF resources had very rapidly to 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. Perhaps unsurprisingly, countries which did not rely on IMF assistance maintained more heterodox policies – and this shows up in their relatively unperturbed levels of social spending.

Who was Affected? [3]

Financial crises affect the politics, economics and social distribution within countries. Politically, a financial crisis can reconfigure the power of particular interest groups and key office holders in government, as well as agencies of government. The crisis itself may discredit a government or particular officials within it, as did the crisis in Argentina. Equally a crisis can bring to the fore particular officials, hugely empowering them, as happened with Kemal Dervis in Turkey. More systemically, negotiations with the IMF immediately place particular agencies in a pivotal position. Usually it is with the Central Bank or Ministry of Finance that the IMF negotiates.

The financial effects of a crisis and measures taken to manage it include the effects devaluation which can increase the competitiveness of exporters, or import-substitutes, and change the value of investments according to their denomination. Involuntary restructuring or default on debt and an increase in government debt are equally important financial effects.

The social effects of a crisis include 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 were doubtless affected, depending on the status of safety nets and social provision, although the available data in most cases makes this difficult to track, as is the impact on access to health and education as government expenditures and access to services was affected by the crisis. Unfortunately, there is no single, comparable source for evaluating the social effects of different policies and strategies for managing a financial crisis. World Bank country data shows annual changes at the country level, but does not disaggregate by sector or location (urban, rural).

In each of the cases in this study, macroeconomic data gives an indication of the overall depth of the crisis, including the cuts in government expenditure which directly affect the access to services enjoyed by the population. Wherever possible we have used macroeconomic indicators available from IMF Programme documents and Country Reports.

More direct welfare indicators which more accurately capture the social effects of the crisis are much more difficult to find. We found that there is little available from the multilateral institutions. High-level welfare indicators are not available in IMF documents. 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 is missing for many of the indicators and years needed. 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[4]. Argentina, Indonesia and Turkey, all faced a collapse in GDP of around 10% or more. Yet the patterns of expenditure in each of these IMF-programme countries was 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). 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 programmes and those without. In the latter the macroeconomic effects of crisis were less severe but nevertheless their social expenditure patterns are 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),[5] government expenditure had been rising prior to the 1997 crisis by 18.6% between 1995/6 and 1996/7 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 just 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 the year to 2001 and by 9.7% and 2.1% in the year to 2002.

In India (using India's own statistics in constant 1993/4 prices),[6] we find a steadily increasing expenditure on health and education across the 1990s. Education expenditure increased by 21.07% in 1990/1 and then by 30.39% in 1995/6, 33.69% in 1997/8 and 42.03% in 1998/9. Health expenditure was already rising by 6.47% in 1990/1, and rose by 9.88% in 1996/7, by 10.59 in 1997/8, and by 11.27 in 1998/9. 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. We expected to find more accurate and nuanced data from the IMF and World Bank since in the absence of such data, it is difficult to see how the international organisations involved in promoting economic and human development can gauge the social effects of their interventions in the management of financial crises: either *ex post* or, as importantly, at the time of policy-design. Aggregate macroeconomic data tells us certain things about the aggregate state of the economy. But to the extent that the available data does show a very significant social – as well as economic – shock following financial crisis, it is critical that resources be devoted to understanding better how this is manifested and how policies may be designed so as to minimise its effect on vulnerable sections of the population.

Conclusions

The pathway a country takes through a financial crisis is undoubtedly affected by its relationship with the IMF. However, that relationship can have any one of at least three principal effects, some of which might play out together.

The IMF has a constraining effect on crisis management in some countries. The institution is often accused of forcing narrow priorities and prescriptions on countries in no position to argue back. There are strong institutional reasons for such behaviour. Fund staff must move quickly to come up with a programme to which their own management as well as a crisis-ridden country's government will agree. That programme must in turn be designed to produce immediate effects in order to justify disbursement and the short-term nature of the instrument. The result is a narrowing of the policy options to a fairly standardized set of stabilization and adjustment policies which leave little room for a government to adapt its response to a crisis to specific vulnerabilities in its economy and in its social and political systems.

A more positive effect of IMF involvement is agenda enlarging. Where a government is in a position to use the technical information and analysis of the IMF to inform its own decisions, that analysis can assist it in making decisions. More politically, the relationship with the IMF might help to bring necessary (but previously taboo) reforms to the policy-making table. However, this effect can all too easily slip one of two ways. Where government capacity and bargaining power is not strong, the agenda-narrowing effects outlined above can result. Alternatively, a strong government might play politics to transform an agenda-enlarging effect into a permissive effect.

The permissive effect of the IMF derives mainly from the resources the IMF brings to the table and the policy space these resources open up. More money permits a government to postpone necessary reforms with the result that the crisis depends and the eventual cost of resolution grows. Politically, the result is to defer the accountability of officials taking the key decisions – in some cases holding turbulence at bay until the responsible officials have moved out of office. Economically, the results of the permissive effective have been described as harsher, more sustained, and less fair than the market (Bordo and Schwartz).

The cases in this study illustrate these effects at work and underscore the need for political economists to examine the effects of engagement with the IMF not just on the economy of a country managing a financial crisis but on its political institutions and policy-choices.

Endnotes

[1] Eichengreen 1998, 1999, 2000; Fischer 2003, Goldstein 2002, [complete]

[2] Normally this means they do not have adequate foreign reserves (Bird 1996). Economists debate the extent to which countries turn to the IMF because their balance of payments deficit increases (cf. Santaella 1996, Goldstein and Montiel 1986 vs Knight and Santaella 1997, Conway 1994, Edwards and Santaella 1993).

[3] I am indebted to Calum Miller and Devi Sridhar for their contributions to this section.

[4] The data reported here is collated from the following sources:

[5] Using 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

[6] Using the statistics on trends in Central Government budget expenditure provided by the Government of India Department of Statistics (General Statistics) at http://mospi.nic.in/. See a good analysis offered by Abusaleh Shariff, Pabir K Ghosh and Samir K Mondal, 'Indian Public Expenditures on Social Sector and Poverty Alleviation Programmes during the 1990s', *ODI Working Paper 169* (ODI, November 2002).

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