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Asian Economic Crisis and the Role of IMF: An Appraisal

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ABSTRACT

The financial crisis, which was erupted in Asia through the collapse of the Thai Bath in July 1997, led to sharp declines in the currencies, stock markets and other assets prices of a member of Asian countries. This crisis threatened those countries financial systems and disrupted their real economics, with large contractions in activity that created a human crisis alongside the financial one. Moreover, this financial precipitated deep recessions in the "tiger economies", resulting in a sharp drop of living standards together with rising unemployment and social dislocation. Not in the region, rather the crisis has put pressure on emerging markets outside the region; contributed to virulent contagion and volatility in international financial markets. International Monetary Fund (IMF) came to the rescue. Some countries adopted IMF policies while others did not. Quite interestingly though countries like Malaysia that did not take any loan from IMF recovered at faster pace than IMF loan receiving countries. This posed a blatant challenge towards the vitality and viability of IMF structural programs not only in East Asia but also in other parts of the world. In light of that challenge, this paper analyzes the root causes of the Asian crisis and the role of IMF in tackling the crisis. It does a comparative analysis between IMF loan recipient countries like Indonesia, Korea, Thailand, and non-recipient country Malaysia in order to know whether IMF policies helped or hindered economic recovery.

1. INTRODUCTION

Two general interpretations dominate the debate. One blames poor economic fundamentals and policy inconsistencies while the other argues that Asia fell victim to a financial panic, where negative sentiment became self-fulfilling. According to the 'fundamentalist' view, the Asian crisis (along with most other financial crises) was caused by basic economic weaknesses. Proponents of this view argue that Asia's healthy macroeconomic indicators-low inflation, fiscal balance, low stock of government debt, high rates of domestic saving and

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investment (see table 1-6)-painted a misleading picture. They argue that in reality, Asia's economies suffered from serious structural problems as well as policy inconsistencies. They point out that warning signals existed: for instance, in Thailand and current account deficit was dangerously large and rising fast. Moreover, benign macroeconomic indicators, such as a healthy budget balance, could mask real economic weakness. Many Asian governments provided implicit guarantees to the banking system, which often engaged in lending practices that favored financially unqualified borrowers. These implicit guarantees led banks to lend recklessly. This, in conjunction with poor corporate governance in many of these countries, created a large stock of non-performing loans, thereby risking the banks collapse. This meant that the governments' implicit guarantees created a sizable "contingent fiscal liability".

Table1: GDP growth rate

Country/Year	1991	1992	1993	1994	1995	1996	1997
Korea	9.13	5.06	5.75	8.58	8.94	7.10	5.47
Indonesia	6.95	6.46	6.50	15.93	8.22	7.98	4.65
Malaysia	8.48	7.80	8.35	9.24	9.46	8.58	7.81
Thailand	8.18	8.08	8.38	8.94	8.84	5.52	-0.43

Table 2: Inflation Rate

Country/Year	1991	1992	1993	1994	1995	1996	1997
Korea	9.30	6.22	4.82	6.24	4.41	4.96	4.45
Indonesia	9.40	7.59	9.60	12.56	8.95	6.64	11.62
Malaysia	4.40	4.69	3.57	3.71	5.28	3.56	2.66
Thailand	5.70	4.07	3.36	5.19	5.69	5.85	5.61

Table 3: Government Fiscal Balances (% of GDP)

Country/Year	1991	1992	1993	1994	1995	1996	1997
Korea	-1.63	-0.50	0.64	0.32	0.30	0.46	0.25
Indonesia	0.45	-0.44	0.64	1.03	2.44	1.26	0.00
Malaysia	-2.10	-0.89	0.23	2.44	0.89	0.76	2.52
Thailand	4.79	2.90	2.13	1.89	2.94	0.97	-0.32

Table 4: Savings Rates (% of GDP)

Country/Year	1991	1992	1993	1994	1995	1996	1997
Korea	35.74	34.88	34.91	34.60	35.14	33.60	33.06
Indonesia	31.10	33.41	28.66	29.52	27.65	27.50	27.98
Thailand	34.83	33.73	34.26	33.89	33.25	33.22	32.64
Malaysia	23.24	30.06	27.70	33.81	34.65	37.81	39.34

Table 5: Current Account, BOP Definition (% of GDP)

Country/ Year	1991	1992	1993	1994	1995	1996	1997
Korea	-2.83	-1.28	0.30	-1.02	-1.86	-4.75	-1.85
Indonesia	-3.56	-2.17	-1.33	-1.58	-3.18	-3.37	-2.24
Malaysia	-8.69	-3.74	-4.66	-6.24	-8.43	-4.89	-4.85
Thailand	-7.71	-5.66	-5.08	-5.60	-8.06	-8.10	-1.90

Table 6: Investment Rates (% of GDP)

Country/Year	1991	1992	1993	1994	1995	1996	1997
Indonesia	35.50	35.87	29.48	31.06	31.93	30.80	31.60
Korea	38.90	36.58	35.08	36.05	37.05	38.42	34.97
Malaysia	37.25	33.45	37.81	40.42	43.50	41.54	42.84
Thailand	42.84	39.97	39.94	40.27	41.61	41.73	34.99

Note: The source of all Data in this Table is *the International Financial Statistics* of the IMF.

By contrast, the panic interpretation views the self-fulfilling pessimism of international lenders as the root cause of the crisis. The most sophisticated version of this argument interprets Asia's crisis as a classic bank run. In a bank run, if enough investors are suddenly seized with panic and demand immediate payment, then financial intermediaries are forced to destructively liquidate long-term assets at a great loss. In the classic model of a panic, the central bank can prevent such a destructive bank run by acting as lender of last resort and providing liquidity to the market. However, in the international version of a bank run, if a country's exchange rate is fixed and foreign exchange reserves are limited in relation to short-term external debt, as was the case in some Asian crisis-affected countries, no mechanism for stemming panic is available. In Indonesia, Korea and Thailand short-term external debt exceeded international reserves immediately before the crisis (see Table 7) and indeed, for more than two years prior to the crisis.

Table 7: Short-term external Debt and International Reserves Prior to the Crisis, Selected Asian economies, Second Quarter of 1997

Country/Economy	Short-term debt ($billion)	International Reserve ($Billion)	Debt-reserve Ratio
Korea	70.18	34.07	2.06
Indonesia	34.66	20.34	1.70
Malaysia	16.27	26.59	0.61
Thailand	45.57	31.36	1.45

Source: The source of all Data in this Table is *the International Financial Statistics* of the IMF.

Note: Short-term debt: Bank for International Settlements data; reserves: IMF; staff estimates

2. WHICH EXPLANATION FITS ASIA BEST?

At first sight, the past stellar economic record of the Asian economies does not support the fundamentalist interpretation. However, closer inspection clearly shows that these countries' economic success was built on a particular kind of economic strategy that emphasized export orientation, centralized coordination of production activities and implicit (or even explicit) government guarantees of private investment projects, as well as a close operational relationship and inter-linked ownership between banks and firms. Widely referred to as Asian industrial policy, this strategy allowed firms to rely heavily on bank credit. By international standards, firms in crisis-affected countries were extraordinarily highly leveraged. In Korea and Thailand, for instance, the average debt-to-equity ratios in 1996 were above 200 percent. In Indonesia debt-to-equity ratio was lower, but nevertheless high by international standards. (see table 8)

Table 8: Selected Indicators of Corporate Financing, Selected Asian Economies, 1996

Country/Economy	Debt-to-equity ratio		Ratio of Short-term debt to total debt	
	Mean	Median	Mean	Median
Korea	3.55	3.25	0.57	0.59
Indonesia	1.88	1.83	0.54	0.57
Malaysia	1.18	0.90	0.64	0.70
Thailand	2.36	1.85	0.63	0.67

The financial sector was also exhibiting significant problems. Weak prudential regulation, lax and inexperienced supervision, low capital adequacy ratios, lack of adequate deposit insurance schemes, distorted incentives for project selection, and sometimes outright corruption all rendered the region's financial systems weaker than they appeared. For many years, most Asian economies kept their financial systems relatively closed. Foreign borrowing was limited and capital inflows were controlled. These controls ensured that the region's financial sectors remained immune from external shocks despite their domestic fragility. Most important, controls prevented domestic fragility from being translated into external vulnerability in the form of short-term, unhedged foreign debt. This changed during the 1990s. As international capital markets were gradually opened and domestic markets were deregulated, supervision and regulatory oversight did not improve in tandem. For example, Thailand's now infamous finance companies grew rapidly during the 1990s with virtually no regulatory oversight.

The 1990s also saw a dramatic increase in foreign borrowing. While Asian companies maintained their strong bias in favor of debt financing, foreign debt financing became increasingly important (see table 9 for corporate debt composition in selected Asian economies in 1996). The pegged exchange rate eliminated exchange risks in borrowing in dollars. At the same time international investors were falling over themselves to lend: interest rates in the industrial countries were low, promoting a search for higher yields elsewhere and optimism about Asia's prospects was high. Between 1991 and 1996 overall borrowing doubled in Malaysia and Thailand and grew by one third in Korea**.** The fundamentalist interpretation of the crisis links this extraordinary optimism among foreign investors to their belief that borrowing was ultimately guaranteed either by Asian governments or by international institutions. The panic interpretation regards the optimism as rational, based on the correct judgement that these economies were fundamentally sound.

Table 9: Corporate Debt Composition, Selected Asian Economies, 1996 (percent)

Foreign Debt			Domestic Debt	
Country/Economy	Short term	Long term	Short term	Long term
Korea	29.4	17.0	27.7	25.8
Indonesia	20.5	19.6	31.4	28.5
Malaysia	32.1	11.0	35.7	21.2
Thailand	29.6	12.3	32.0	26.1

Note: The source of all Data in this Table is *the International Financial Statistics* of the IMF.

Although specific characteristics varied, a pattern of increasing vulnerability to external shocks emerged in all regional economies prior to the crisis. First, short-term borrowing to finance long-term projects became increasingly important, especially in Korea, Malaysia and Thailand. This created a sizable maturity mismatch in the balance sheets of domestic banks lent to domestic firms in local currency, while borrowing short term in foreign currencies without hedging. This created a significant currency denomination mismatch. Third, the easy availability of credit fueled investment in increasingly risky assets. In some countries the credit boom was translated into bubbles in real estate and property. In other countries financial resources were directed toward over-investment in narrowly specialized industrial such as electronics or large, prestigious projects with unclear benefits. These poor and risky investments, in turn, worsened the quality of the portfolios of domestic financial institutions, thereby in creasing the risk of panics and subsequent crises.

At the same time, several factors combined during the 1990s to worsen the fundamental economic outlook for the region. The rapid appreciation of the US dollar since 1995, to which most of the region's currencies were pegged in some way; the increasing competition from the People's Republic of China (PRC) in export markets; and the prolonged slowdown of the Japanese economy were all reflected in slower export growth, rising current account deficits, depressed stock markets and widespread corporate difficulties long before the outbreak of the crisis. In 1996, for instance, 20 of the largest 30 Korean conglomerates had rates of return below the cost of invested capital, and in the first months of 1997, 7 of the 30 largest conglomerates were effectively bankrupt.

As these financial difficulties emerged, some governments played an increasingly active role in reassuring international investors about their willingness to back domestic financial firms. A case in point is the collapse of the large Thai finance company, Finance One. In the months preceding the crisis, the Bank of Thailand repeatedly confined to foreign investors its willingness to "back Finance One all the Way"
In the first half of 1997, despite the worsening financial environment, capital inflows did not slow down, but increasingly took the form of short-term, inter-bank loans that could be readily withdrawn and could count no formal guarantees in the inter-bank markets. However, once the crisis began, international banks suddenly stopped lending and began to call in their loans. A huge amount of private foreign capital fled the region in the second half of 1997. Between them, Indonesia, Korea, Malaysia and Thailand received a net capital inflow of about $76 billion in 1996, but suffered a net capital outflow of around $36 billion in 1997. This implies a difference of approximately $112 billion, or about 12 percent of the countries combined Gross Domestic Product (GDP). Commercial bank withdrew about $26 billion from the crisis-affected countries in 1997, after lending them about $63 billion in 1996.

The suddenness and speed with which capital fled the region in the second half of 1997 gives credence to the panic interpretation of the crisis. However, as this section has shown, it was the region's structural weaknesses that initially created the vulnerability to crisis.

3. DEALING WITH CRISIS: A KEYNESIAN SOLUTION

Economists have developed an entire literature that tries to analyze crisis using classic Keynesian Economics model. In the Keynesian framework, apart from doing nothing there are, in principle, two policy approaches to deal with such a crisis. The first is to implement policies that would restore the confidence of private investors, so that lender will be prepared to lend and borrowers to borrow again. (In the language of Keynesian economics, the aim is then to shift the marginal efficiency of capital schedule-which refers to expectations of profitability to the right.) This needs to restore confidence has clearly been the primary emphasis of IMF programs and of recommendations coming from Washington and more generally, from people in the financial sector.

The second approach is to compensate for the initial decline in private investment with a fiscal expansion, requiring deficit finance. In this case the private investment decline itself is accepted as inevitable and not quickly reversible, either because it would be difficult and take a long time to reverse, or because it was to a considerable extent a justified decline based on fundamentals, such as the emergence of excess capacity in fields where mush of the investment had taken place, e.g., real estate, electronics manufacture and motor car production. Compensation through fiscal expansion would take the form of increased government expenditure, such as expenditures on infrastructure projects which would create demand for some of the building and construction firms that will have lost business owing to the end of the private building boom, and reducing taxes, increased transfers and subsidies that would boost private incomes and hence consumption. Sufficient fiscal expansion, if initiated in time, could avoid a recession completely.

4. THE IMF AND THE ASIAN FINANCIAL CRISIS: INITIAL PROGRAMS

The principal responsibility for dealing with the Asian crisis at an international level was assumed by the IMF, the institution charged with safeguarding the stability of the international monetary system. Thus, a central role for the IMF in resolving the Asian financial crisis was clear, and has been reaffirmed by the international community in various multilateral fora. The IMF’s goal was to quickly restore confidence in the three hardest hit Asian economies-Indonesia, Korea and Thailand-through a combination of tough economic conditionalities and substantial financial support. But question might be raised how much effectively work IMF’s plan? Does it’s plan work for recovery? Or it worsens the situation? Here we will discuss planes and programs of IMF in order to recover from this crisis and then we will see the latest recovery scenario, which will help us to examine the effectiveness of IMF's plan.

In pursuit of its immediate goal of restoring confidence in the region, the IMF responded quickly by helping the three countries most affected by the crisis-

Indonesia, Korea and Thailand-arrange programs of economic stabilization and reform that could restore confidence and be supported by the IMF. It approved in 1997 some SDR 26 billion or about US$35 billion of IMF financial support for reform programs in Indonesia, Korea and Thailand and spearheading the mobilization of some US$77 billion of additional financing from multilateral and bilateral sources in support of these reform programs (see the Table 4). In July 1998, committed assistance for Indonesia was augmented by an additional US$1.3 billion from the IMF and an estimated US$5 billion from multilateral and bilateral sources. IMF also intensified its consultations with members both within and outside the region that were affected by the crisis and needed to take policy steps to ward off the contagion effects, although not necessarily requiring IMF financial support. The IMF's immediate effort to reestablish confidence in the affected countries entailed:

- A temporary tightening of monetary policy to stem exchange rate depreciation;
- Concerted action to correct the weaknesses in the financial system, which contributed significantly to the crisis;
- Structural reforms to remove features of the economy that had become impediments to growth (such as monopolies, trade barriers and nontransparent corporate practices) and to improve the efficiency of financial inter-mediation and the future soundness of financial systems;
- Efforts to assist in reopening or maintaining lines of external financing; and
- The maintenance of a sound fiscal policy, including through providing for rising budgetary costs of financial sector restructuring, while protecting social spending. Once the severity of the economic downturn in the affected countries became clear, fiscal policy was oriented toward supporting economic activity and expanding the social sector safety net.

Table 10: Commitments of the International Community and Disbursement of the IMF in Response to the Asian Crisis (in Billion UD Dollars)

	Commitments				IMF Disbursements As of 1/17/99
Country	IMF	Multilateral (1)	Bilateral	Total	
Indonesia (2)	11.2	10.0	21.1	42.3	8.8
Korea (3)	21.1	14.2	23.1	58.4	19.0
Thailand	4.0	2.7	10.5	17.2	3.1
Total	36.3	26.9	54.7	117.9	30.9

1. World Bank and ADB
2. Includes augmentations since July 1998
3. Disbursements does not reflect Supplemental Reserve Facility Repayments of US$2.8 billion made by Korea in December 1998

Forceful, far-reaching structural reforms are at the heart of all the programs, marking an evolution in emphasis from many of the programs that the IMF has supported in the past, where the underlying country problem was imbalances reflecting inappropriate macroeconomic policies. Because financial sector problems were a major cause of the crisis, the centerpiece of the Asian programs has been the comprehensive reform of financial systems.

To the address the governance issues that also contributed to the crisis, the reform of the financial systems is being buttressed by measures designed to improve the efficiency of markets, break the close links between business and governments and ensure that the integration of the national economy with international financial markets is properly segmented. Transparency is being increased, both as regards economic (on external reserves and liabilities in particular) and fiscal data and in the financial and corporate sectors.
The reform efforts have been invaluably aided by the World Bank, with its focus on the structural and sectoral issues that underpin the macroeconomic and the Asian Development Bank (ADB), with its regional specialization. The IMF's Interim Committee reviewed and endorsed the overall strategy adopted by the international community dealing with the Asian crisis at the 1998 Bank-Fund Annual Meetings in October.

5. ADDITIONAL MEASURES TAKEN BY THE IMF IN RESPONSE TO THE CRISIS

In addition to the IMF's first line of response assisting in the design of the programs and providing financial resources for their support-the following steps have also been taken:

- The Executive Board made use of the accelerated procedures established under the emergency financing mechanism and the exceptional circumstances clause to met the exceptional needs of the member countries in terms of approval time and access.
- The Supplemental Reserve Facility (SRF) was created for the special circumstances of members experiencing exceptional balance of payments difficulties owing to a large short-term financing need resulting from a sudden loss of market confidence.
- The coordination of the IMF with the other international financial institutions, notably the World Bank and the Asian Development Bank, and with bilateral donors was intensified, to muster truly international support for the affected countries economic reform programs.
- A strengthened level of dialogue between the IMF and a variety of constituencies in the program countries was initiated, including

consultations with labor groups and extensive contacts with the press and the public.

- The IMF programs have been associated with coordinated efforts between international creditor banks and debtors in the affected countries to resolve the severe private sector financing problems at the heart of the crisis, and the IMF has provided support to this process as appropriate. Thailand reached an early understanding on debt rollover with key Japanese creditor banks in August 1997. Talks between Korea and a group of foreign creditor banks on the voluntary restructuring of short-term debt began in late December 1997 and were finalized in March 1998. In June 1998, Indonesia and a setting committee of its foreign bank creditors agreed on a framework for the voluntary restructuring of inter-bank debt, trade credit and corporate debt.
- IMF member countries have attained new levels of transference through the release to the public of the letters of intent describing their programs of economic reform. With the permission of the respective authorities of Indonesia, Korea and Thailand, the IMF has posted the letters of intent on the IMF website so that details of the programs are ready available to all interested parties. Korea and Thailand have also issued Public Information Notices (PINs), a relatively new means for countries to make known to the public the views of the IMF Executive Board on national economic policies. All three countries are subscribers to the IMF Special Data Dissemination Standard (SDDS), and Indonesia and Thailand have established hyperlinks from the IMF Dissemination Standards Bulletin Board (DSBB) to their respective national economic and financial data.
- Ad hoc measures have been taken as necessary, including the appointment of former IMF Deputy Managing Director Prabhakar Narvekar as a Special Advisor to the Indonesian authorities; the establishment of resident representative posts in Korea and Thailand (and the expansion of the existing post in Indonesia); and various activities through the IMF’s newly opened Asia and Pacific Regional Office.
- The IMF has been responding to the requests it has received from its members, from its own Interim Committee and from multilateral fora such as the Group of Seven and the Group of Twenty-four nations, to investigate aspects related to the financial crisis, from the role of hedge funds, to promoting financial sector soundness and strengthening the architecture of the international monetary system.

6. The AFTERMATH OF IMF INTERVENTION

6.1 Thailand

On August 20, 1997, the IMF's Executive Board approved financial support for Thailand of up to SDR 2.9 billion, or about US$4 billion, over a 34-month period. The total package of bilateral and multilateral assistance to Thailand came to US$17.2 billion. Thailand drew US$14.1 billion of that amount before announcing in September 1999 that it did not plan to draw on the remaining balances, in light of the improved economic situation.

In the early stages of the program, the Thai authorities adapted monetary policy to a managed float of the baht; fostered the restructuring of distressed financial institutions, including the closure of 56 bankrupt finance companies; enacted budget cuts to free up resources to help finance the restructuring and to support improvement in the current-account position; deepened the role of the private sector in the Thai economy; and sought to attract foreign capital through other reform measures. Thailand's economy returned to positive growth in late 1998, and GDP growth reached over 4 percent in 1999 and should grow by 4.5-5.0 percent in 2000. The balance of payments is expected to remain strong in the near term, even as the current-account surplus declines as the recovery proceeds. Foreign-exchange reserves remain within the $32-34 billion range envisioned in the program. With output recovering and reserves restored to comfortable levels, the authorities treated the IMF loan as precautionary and made no further drawings after September 1999. The stand-by arrangement expired on June 19, 2000.

Table 11: Selected Economic Indicators

E. Indicators/Year	**1996**	**1997**	**1998**	**1999***	**2000***
Real GDP Growth	5.9	-1.7	-10.2	4.2	4.5 to 5.0
Consumer Prices (period average)	5.9	5.6	8.1	0.3	0.3
[Percent of GDP (minus sign signifies a deficit)]					
*Central Government Balance****	1.9	-0.9	-2.4	-2.9	-3.0
Current Account Balance	-6.0	-7.9	-2.0	12.7	9.1
[In Billions of US dollars]					
External Debt	90.5	93.4	86.2	76.0	67.8

Note: The source of all Data in this Table is *the International Financial Statistics* of the IMF.
Note: Thai authorities and IMF staff estimates.
*Estimate, **Projection
***Fiscal year, which runs from October 1 to September 30

6.2 Korea

On December 4, 1997 the IMF's Executive Board approved financing of up to SDR 15.5 billion or about US$21 billion, over three years. The objectives of Korea's crisis resolution strategy were, first and foremost, to restore confidence and stabilize financial markets, and second, to lay the foundation for the resumption of sustained recovery in the real economy. The program thus included a mix of macroeconomic policies and far-reaching structural reforms. In addition, Korea reached agreement with foreign banks in early 1998 to extend the maturity of short-term claims on its banks to avoid default.

Korea recovered strongly and the policies adopted under the IMF-supported program have helped to successfully restore external stability, rebuild reserves, and initiate reform of the financial and corporate sectors. Korea has stopped drawing from the IMF; it also repaid part of the stand-by drawings nine months ahead of schedule. The challenge ahead is to avoid complacency and maintain the momentum of structural reforms.

Table 12: Selected Economic Indicators

E. Indicators/Year	**1996**	**1997**	**1998**	**1999***	**2000****
			Percent Change		
Real GDP Growth	7.1	5.5	-6.7	10.7	8.0
Consumer Prices (End of period)	4.9	6.6	4.0	1.4	1.8
[Percent of GDP (minus sign signifies a deficit)]					
Central Government Balance	0.0	-1.7	-4.4	-3.5	-3.0(1)
Current Account Balance	-4.4	-1.7	12.7	6.1	2.0
[In Billions of US dollars]					
External Debt	164.4	158.1	148.7	136.0	129.6
			Percent of GDP		
External Debt	31.6	33.2	46.9	33.4	26.8

Sources: The source of all Data in this Table is *the International Financial Statistics* of the IMF.
Note: Korean authorities and IMF staff estimates.
*Estimate
**Projection
1. For 2000, includes civil service pension fund.

6.3 Indonesia

On November 5, 1997, the authorities entered into a three-year stand-by arrangement with the IMF for US$ 10 billion, which was augmented by about US$1.4 billion in July 1998. In August 1998, a strengthened reform agenda was reflected in a new extended arrangement with the Fund. To break inflation, the program was anchored in firm base money control. Food security --especially rice--was gradually restored through emergency imports, a strengthened distribution system, and temporary food subsidies. Banking sector reform accompanied by corporate restructuring, an effective bankruptcy system, deregulation and privatization, and improved governance were also at the core of the program. This policy framework delivered important results, economic recovery is gathered pace while inflation remained subdued. GDP grew by 5.8 percent in the last quarter of 1999 relative to the same period of the previous year, enabling a small positive growth in calendar 1999. Consumption and de-stocking continue to be the main engines of the emerging recovery--a pattern shared by other Asian countries emerging from the crisis. Inflation has continued to be virtually flat since June 1999, and interest rates have been brought to pre-crisis levels.

Table 13: Selected Economic Indicators

E. Indicators/Year	**1996**	**1997**	**1998**	**1999***	**2000****
			Percent Change		
Real GDP Growth	8.2	1.9	-14.2	1.5 to 2.5	3 to 4
Consumer Prices (End of period)	5.7	12.9	64.7	-0.6	5.4
[Percent of GDP (minus sign signifies a deficit)]					
Central Government Balance	1.2	-1.1	-2.2	-3.3	-4.8
Current Account Balance	-3.4	-0.9	4.4	3.1	1.9
[In Billions of US dollars]					
External Debt	127.4	135.0	149.9	147.6	149.1
				Percent of GDP	
External Debt	54.5	163.1	129.0	91.0	86.9

Sources: The source of all Data in this Table is *the International Financial Statistics* of the IMF.
Note: Indonesian authorities and IMF staff estimates.
*Fiscal year, which runs from April 1 to March 31
**Program, budget for April 1 to December 31

6.4 Malaysia

Malaysia responded with a tightening of monetary and fiscal conditions, and an emphasis on structural reforms, particularly in financial sector regulations and supervision and improvements in intermediation. It imposed capital controls in September 1998, largely aimed at the offshore Ringgit market in Singapore and short-term portfolio flows. The offshore market was believed by the authorities to constrain their ability to bring down interest rates rapidly. Controls took the form of requirements to bring the Ringgit on-shore by end September, and a one-year holding period for repatriation of portfolio capital inflows. The latter controls were replaced in February 1999 with a system of graduated exit levies, and further relaxed in September 1999.

Malaysian's Economy recovered strongly. In 1999 the real growth was 5.8% and in the first half of the year 2000, it grew 10.3%, with second quarter growth moderating to 8.8% from 11.9% in the first quarter. Against this backdrop, the official projection of 5.8% for the full year now seems overly conservative. Consensus economics (September 2000) projections suggest that the growth rate will be about 8.6%-itself a significant upward revision of earlier estimates. The Malaysia's economy, it would seem, is continuing to surprise on the upside (See Table 14).

Table 14: Selected Economic Indicators

E. Indicators/Year	**1996**	**1997**	**1998**	**1999***	**2000****
			Percent Change		
Real GDP Growth	10.0	7.3	-7.4	5.8	8.5
Consumer Prices (End of period)	3.5	2.7	5.3	2.7	1.5
[Percent of GDP (minus sign signifies a deficit)]					
Central Government Balance	0.7	2.4	-1.8	-3.2	1.2
Current Account Balance	-4.6	-4.7	13.0	15.8	
				Percent of GDP	
External Debt	38.3	43.4	58.5	53.4	

Sources: The source of all Data in this Table is *the International Financial Statistics* of the IMF.
Note: Malaysian authorities and IMF staff estimates.
*Fiscal year, which runs from April 1 to March 31
**Program, budget from April 1 to September 30

7. APPRAISING THE IMF-SUPPORTED PROGRAMS:

The IMF-supported programs were initially less successful than hoped in restoring confidence in all three countries, with capital outflows and currency depreciations continuing after the programs were introduced. Financial markets stabilized in the early months of 1998 in Korea and Thailand, and significantly later in Indonesia. Exchange rates began to recover, and interest rates had declined to below pre-crisis levels by mid-1998. Economic activity then began to turn around in mid-1998 in Korea and later in the other countries. Once they started, the recoveries were unexpectedly robust, especially in Korea, where growth reached 10.75 percent in 1999 as a whole. The recoveries reflected a resurgence of private domestic demand, the collapse of which had produced the recessions. The experience of the Asian crisis and the results of the policy strategy stimulated fresh thinking on the international financial system as well as on the appropriate policy response to financial crises. The key lessons, shared by most observers, are:

- Tight **monetary policies**, when firmly applied, did work in reversing exchange rate pressures and preventing inflationary spirals. In Korea and Thailand, after a period of negative real interest rates, currency depreciation, and rising inflation at the outset of the Fund-supported programs, interest rates were raised to high levels in real terms for a few months. Market conditions stabilized, currencies recovered, and interest rates were lowered to below pre-crisis levels; a cycle of inflation and depreciation was thus avoided. Indonesia, in contrast, maintained negative real interest rates through the middle of 1998, with rampant monetary expansion associated with banking collapse and political and social turmoil. The collapse in its currency was much more severe and drawn-out than in the other countries. These experiences cast serious doubt on the claim by some critics that monetary tightening was counterproductive and even accelerated the currency depreciations.
- The programs' initial **fiscal objectives**, based partly on the assumption (held by most observers at the time) of moderate economic slowdowns, were too tight. They were adjusted, as it became clear that the countries were entering severe contractions, and the collapse in private demand was generating massive current account surpluses. In all three countries, the easing began in early 1998, i.e., only two months after the start of the programs in Indonesia and Korea. In retrospect, this easing should have come earlier, particularly as these countries had entered the crisis with strong fiscal positions and low public debt. While fiscal policy was not a major cause of the recessions, it could have done more to counteract the decline in private demand, which in turn appears to have been driven largely by the balance sheet effects of the crisis itself.
- **Structural reforms** were clearly needed to restore confidence on a firm basis, by addressing some of the root causes of the crises. But the

programs did not initially focus sharply enough on the financial sector and corporate issues; this focus came later, as the linkages were better understood. More generally, the experience raises issues regarding the focus of structural reforms as well as their pace and sequencing. Some of these issues were resolved as the programs unfolded: some reforms were delayed while others, seen as less essential, were winnowed out.

- Experience with financial sector restructuring also highlighted the need for clear **government guarantees of bank deposits** in the event of a crisis. This figured, in particular, in the closure of 16 banks in Indonesia in November 1997. These banks were deeply insolvent and there is little doubt that they needed to be shut promptly to prevent a hemorrhage of public money to support them. But no announcement was made at the time regarding the treatment of depositors in possible future closures of other banks, which were generally understood to be very likely. This partly reflected concern that a full and well-publicized guarantee could have led to moral hazard. In hindsight, these concerns should have been subordinated to the danger of imminent banking system collapse. Uncertainty regarding the scope of prospective government guarantees appears to have been a major factor accelerating bank runs--until January 1998, when a blanket guarantee of all bank liabilities was announced;
- A more heavy-handed approach, possibly involving capital controls, was not pursued partly on the grounds that it could have exacerbated contagion. But as confidence was not restored quickly, concerted **private sector involvement** (PSI) became necessary in all three countries to stem capital outflows. In Thailand, the authorities reached an early understanding with foreign banks to maintain credit lines to their Thai subsidiaries; Korea's major bank creditors were pressed to keep their money in place in December 1997, a few weeks after the program had begun; and in Indonesia, there was a de facto standstill on corporations' external debt servicing, and later a framework was established for restructuring this debt. This experience raised questions of whether PSI should have been organized sooner--notably in Korea, where a funding crisis loomed a few weeks after the initial program was introduced. The experience also gave impetus to work on establishing modalities for PSI that can be activated in the event of a crisis, but also with a view to underpinning confidence and thus helping forestall crises.

The economic recovery of most of the crisis countries has been more rapid than anticipated by many observers. The pessimistic scenarios developed during the height of the problems have been avoided. Strong real output growth is now occurring in most of the crisis countries generated by private consumption and exports and some new private investment. Monetary policies in the region remain accommodative, for the most part, in order to underpin economic growth. In many cases, real and nominal money market interest rates are below pre-crisis levels. Fiscal consolidation is occurring gradually as recovery takes hold; budgetary deficits are being eliminated, despite the costs of financial sector reforms, and policies are returning to the principles of minimizing domestic financing and avoiding excessive public debt. External current account positions remain in surplus, in part because of competitiveness gains and strong world demand for electronics, which are offsetting increased import demand associated with faster growth. Official international reserves have been rebuilt, making the countries less vulnerable to external shocks. Most regional equity markets have experienced gains since the depths of the crisis, although they remain well below pre-crisis levels in dollar terms.

It is thus fair to say that is no big gulf between IMF loan recipient countries and non-recipient countries, rather non-recipient country like Malaysia recovering faster. Therefore, it is very hard to say that without IMF's help no country can survive, rather IMF’s loan recipient countries have to follow its conditions those sometimes create more problems.

8. CONCLUSION

Despite recent achievements, there are continuing concerns as to whether the economic recovery will lead to sustained growth, or whether vulnerabilities may reemerge. While the track record may be better than some critics predicted, structural reforms have not proceeded as rapidly as desired. It is essential to ensure the completion of the large unfinished agenda of structural reforms. This is a major and difficult task, for which political support may not always be forthcoming. It is important to prevent reform fatigue and complacency setting in because of the recent strong economic performance. It remains necessary to: accelerate financial sector restructurings and intensify corporate restructuring, focusing on restoring viable corporate balance sheets, both through work-outs with creditors that provide for debt restructuring and operational restructuring to restore competitiveness and profitability. It is an imperative to continue the process of market opening and deregulation, including further trade liberalization and simplification of business licensing requirements. These measures are needed to improve the environment for private investment, especially to attract new foreign direct investments and enhance productivity growth. Regional initiatives can also be helpful in supporting sustained economic growth and stable financial relations among participating countries. With the above actions in place, and preservation of financial stability through appropriate macroeconomic policies, the Asian crisis countries are likely to emerge stronger than before and fitter for the competitive global environment of the twenty-first century: the countries' economies will be more market-oriented and more transparent; their financial institutions will be stronger and better regulated; their corporate enterprises will be more competitive; and their social safety nets will be substantially improved.

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