Martin Feldstein, "Refocusing the IMF" *Foreign Affairs* March/April (1998): 20-33

THESIS

The IMF overdoes it, as proven by its programs for Korea. The IMF should not use currency crises as opportunities to impose structural and institutional reforms on countries.

SUMMARY

In the Asian currency crisis, the IMF is risking its effectiveness by the way it defines its role and by its handling of the affected countries. The IMF has steadily increased since its creation, through the Latin American debt crisis and the collapse of the communist economies. In the transitioning economies, the IMF offered advice on the widest range of issues, and it is doing the same in Southeast Asia and Korea. The IMF is insisting on fundamental changes in economic and institutional structures as a condition for receiving IMF funds, as well as the traditional mix of fiscal policies and credit tightening. / Thailand's crisis was a combination of a persistent current account deficit and its misguided attempt to maintain a fixed ER to the dollar. The current account deficit had persisted with some devaluation of the baht because investors thought Thailand was different. The decline of the yen against the dollar and Thailand's heavy trade linkage with Japan put the final pressure on the baht, which the government could not defend anymore. The crisis spread to Indonesia, Malaysia and the Philippines. All these countries clearly needed the traditional IMF medicine of reducing spending, but the IMF went far beyond in Asian than it did in Latin America. It prescribed programs requiring the governments to reform their financial institutions and to make changes in their economic structures and political behavior. The Korean situation was different. Korea did not have overvalued ER nor excessive current account deficit; the economy was performing well. Korea got in trouble because its short-term foreign debts far exceeded Korea's foreign exchange assets. Korea's problem was temporary illiquidity rather than fundamental insolvency. What Korea needed was coordinated action by creditor banks to restructure its ST debts. Instead, the IMF, the U.S. the WB, and Japan organized a %57 billion package with conditionalities—to fully liberalize foreign investment (acquisition); liberalize financial markets to foreign businesses; liberalize import market, especially Japanese cars; increase Western banking standards; make the Bank of Korea independent and its goal stability; break up chaebols; decrease debt-to-capital ratios of corporations; increase labor market flexibility. / The IMF cannot initiate programs but develop programs for a member country, when that member seeks help. "A nation's desperate need for short-term financial help does not give the IMF the moral right to substitute it technical judgments for the outcomes of the nation's political process." Feldstein obviously doesn't agree with IMF's programs, and Korea is the archetypal case. The system Korea has developed may very well have suited Korea's stage of economic and political development and its cultural values. In that light the prescribed long-term adjustment is questionable. So are the short-term policies. Korea didn't have to tighten its monetary policy and reduce budget deficit, when its national savings rate is already one of the highest in the world. Korea's interest rate did not need to be raised when it's inflation was low, and the high interest rate would bankrupt banks and reduce confidence in the financial system. Korea was forced into create a credit crunch, leading to corporate failures, when Japan refused to do the same. / The IMF is successful in sending the wrong message. While, no perfect solution exists to the moral hazard problem the IMF offers, the message send to the emerging-market economies by the painful and comprehensive reform programs is that they should avoid calling in the IMF. Moreover, in order to protect themselves, the emerging economies end up inefficiently accumulating large foreign reserves. While the message Korea needed sent out was that its problem was a temporary shortage, IMF's emphasis on the structural and institutional problems sent out the opposite message. The IMF should not be a vehicle for major shareholders to carry out their desires. The IMF should eschew the temptation to use currency crises as an opportunity to force fundamental structural and institutional reforms on countries. The IMF should remember hat the borrowers and the lending bankers or bondholders should bear the primary responsibilities for resolving the problems that arise from the inability of countries' corporations in meeting their international debt obligations. The IMF should serve as a monitor and provide funds as an indicator of increasing confidence, rather than bailout international lenders and domestic borrowers. The IMF should proactively help countries with large current account deficits to keep currency crises from precipitating. Client-focused and supportive IMF, rather than the imposer of painful contractions and radical economic reforms, will render countries more willing to invite its assistance in times of need.