COMMENT

TO THINE OWNSELF BE TRUE: IMF CONDITIONALITY AND EROSION OF ECONOMIC SOVEREIGNTY IN THE ASIAN FINANCIAL CRISIS

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1. INTRODUCTION

Prior to World War II, there was no international financial system in existence. The International Monetary Fund ("IMF"), designed to serve as the center of the postwar international monetary system, was established to focus on member states' Balance of Payments ("BOPs"), exchange rates, and exchange controls. However, the IMF was not designed to influence member states' domestic policies or priorities primarily because the economic sphere was thought to be something that could be separated from the areas of domestic governance. Gradually,

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4 The Balance of Payments ("BOPs") is a statistical statement that summarizes the economic transactions of an economy with the rest of the world for a specific period, typically a year or quarter. It covers: (1) all the goods, services, factor income, and current transfers an economy receives from or provides to the rest of the world; and (2) capital transfers and changes in an economy's external financial claims and liabilities.
however, it became clear that the barrier between domestic and international policies could not be maintained. After the IMF made loans to relatively industrialized countries in the 1960s and early 1970s, it was apparent that the borrowing countries were subject not only to the laws of economics, but, to a considerable extent, the judgments of the international community, represented by the IMF. Thus, by the time Asia was struck by financial turmoil in 1997, it was understood that the IMF, prior to making its resources available, could ask for certain conditions from a potential borrower-state. However, much of the IMF’s conditionality was focused on macroeconomic variables until the Asian financial crisis. Unlike Mexico and other Latin American countries, Asian countries had experienced low budget deficits, relatively low public debt, inflation in single digits, rapid economic growth, and high savings and investment rates. It seemed, at least to the IMF, that the cause of the Asian financial crisis was failure of the internal management. The IMF thus looked closely at the

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5 For example, Britain obtained an International Monetary Fund ("IMF") loan in 1967 following the devaluation of the pound. See Andreas F. Lowenfeld, The International Monetary System and the Erosion of Sovereignty: Essay in Honor of Cynthia Lichtenstein, 25 B.C. INT’L & COMP. L. REV. 257, 261 (2002).

6 Credit from the IMF is generally conditioned upon the borrowing country’s commitments to certain economic and financial policies. Conditionality refers to this requirement by the IMF that the borrowing country should adopt policies to resolve its BOPs difficulties, contribute to strong and sustainable economic growth, and enable the government to repay the IMF. For a discussion of conditionality, see The International Monetary Fund, IMF Conditionality: A Factsheet, Dec. 4, 2002 [hereinafter IMF Conditionality], at http://www.imf.org/external/np/exr/facts/conditio.htm (last visited Oct. 19, 2003). Recently, the IMF Board has revised the guidelines on conditionality stating that the revision was made to focus more sharply on the conditions attached to its financing to be clearer about the purposes of conditionality, and to be flexible and responsive in discussing alternative policies with countries requesting financial assistance. See The International Monetary Fund, Guidelines on Conditionality (2002), available at http://www.imf.org/External/np/pdr/cond/2002/eng/guid/092302.pdf (last visited Oct. 19, 2003).

7 In this Comment, “Asia” refers to Southeast Asia and/or East Asia, including countries such as Japan, South Korea, China, Taiwan, Singapore, Indonesia, Malaysia, and the Philippines.


9 In its post-crisis analysis, the IMF characterizes the Asian financial crisis as a capital account crisis. See The Independent Evaluation Office, The International Monetary Fund, The IMF and Recent Capital Account Crises:
private sector and secured commitments related specifically to private activity. Declaring that the financial crises in Asia stemmed from weaknesses in financial system and governance, the IMF required an unprecedented broad range of structural reforms in Asia, because it believed that no economic recovery was possible without curing fundamental, structural "defects" in Asia. The IMF has maintained that the clearest evidence that such reforms were necessary in Asia was the successful recovery of the South Korean economy by the end of 1999. The IMF's argument, then, was that the policies and decisions that were normally within the purview of purely domestic governance were a major contributor to the subsequent economic woes. In effect, sovereignty of a nation embodied within internal management and domestic policies was something that the IMF had decided to modify at a fundamental level, if deemed necessary.

However, the rather different outcomes in Malaysia and Thailand\(^\text{10}\) suggest that the success of economic recovery does not provide the justification of eroding sovereignty through the IMF conditionality. Viewed from an economic standpoint, much of the IMF conditionality was at least somewhat questionable for its effectiveness, necessity, and justification. The IMF cannot provide objective proof for its contention that its conditionality in fact assists troubled economies in recovering quickly and effectively from financial turmoil.\(^\text{11}\) Section 2 of this Comment examines the

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\(^{11}\) "Thailand, though strictly followed the IMF conditionality, had been in a deep economic recession for at least three years since 1997." Stiglitz, supra note 10, at 126-27. The Indonesian economy also suffered from lengthy depression and political instability which were caused in part by the IMF conditionality.

Excessively austere policies—whether they be contractionary monetary or fiscal policies in Argentina or cutting off food subsidies to the poor in Indonesia—predictably give rise to turmoil. This is especially the case when it is believed that there are massive inequalities—such as, billions going to corporate and financial bailouts in Indonesia, leaving nothing
creation of the IMF and its purposes, history, and development. Section 3 examines the Asian economies before the crisis and explores possible causes of the Asian financial crisis. In particular, Section 4 discusses the South Korean economic crisis and the conditionality imposed by the IMF in exchange for the rescue loan. This section also criticizes and questions the IMF's "one-size-fits-all" approach to every country in the region. Section 5 of the Comment suggests changes in the IMF policies and its governance.

This Comment concludes, in Section 6, that the IMF's conditionality is questionable in both a legal and an economic sense. The IMF can potentially play a useful role in preventing economic crises and helping crisis economies to recover by focusing on its stated purposes in the Articles of Agreement. The IMF should not be used to erode the sovereignty of the mostly developing, borrowing countries in order to promote the interests of the IMF itself or those of the developed countries.

2. THE IMF: ESTABLISHMENT, PURPOSES, AND EVOLUTION

2.1. Creation and the Purposes of the IMF

2.1.1. Creation

Following World War II, the international economic system was redefined by the agreements of the United Nations ("U.N.") Monetary and Financial Conference at Bretton Woods. These agreements are known as the Bretton Woods system,12 which had three pillars: the IMF, the International Bank of Reconstruction and Development ("World Bank"),13 and the General Agreement on

left for those forced into unemployment.

Id. at 219.

12 The Bretton Woods system was based on stable and adjustable exchange rates. Exchange rates were not permanently fixed; there were occasional devaluations of individual currencies to correct fundamental disequilibria in the BOPs. Ever increasing pressures in the 1960s culminated in the collapse of the Bretton Woods system in 1971, and it was reluctantly replaced with a regime of floating exchange rates. For a general discussion of the Bretton Woods system, see Michael D. Bordo, The Bretton Woods International Monetary System: A Historical Overview, in A Retrospective on the Bretton Woods System: Lessons for International Monetary Reform 3 (Michael D. Bordo & Barry Eichengreen eds., 1993).

13 The World Bank was created to assist in the development process of member states, specifically to arrange for loans intended to facilitate economic
Tariffs and Trade ("GATT"). These agreements came about after the world realized that concerted efforts to finance the reconstruction of Europe were necessary and that there might be another Great Depression following World War II. It is very important to remember that the U.N. Charter explicitly states that matters "essentially within the domestic jurisdiction of any state" are not the concern of any international organizations that were created at the close of World War II. This language of the U.N. Charter Article 2 is generally applicable to all U.N.-created organizations.

2.1.2. Purposes

On July 22, 1944, the U.N. Monetary and Financial Conference adopted the "Articles of Agreement of the International Monetary Fund." Article I provides that the IMF was established:

a) to promote international monetary cooperation, exchange stability, and orderly exchange arrangements;

b) to foster economic growth and high levels of employment; and

c) to provide temporary financial assistance to countries to help ease BOPs adjustment.

Therefore, its original mandates were enacted to enhance global stability and to ensure that there were necessary funds for countries facing a threat of recession to pursue expansionary policies.

2.2. History and Development of the IMF

Although there have been some changes in the Bretton Woods system in the last five decades, the system remains mostly intact. For example, floating currency exchange rates have replaced fixed rates pegged to gold, and the IMF and World Bank now perform projects.

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14 General Agreement on Tariffs and Trade ("GATT") was the mechanism by which states could resolve disputes and increase the volume of international trade through the lifting of national restrictions.

15 U.N. CHARTER art. 2, para. 7.


17 Id. art. I.

18 For a discussion of the gold-exchange standard, see Bordo, supra note 12.
some of each other’s original functions. However, one important change is the IMF’s stance towards its role in the international monetary system. The IMF has taken the position that almost everything falls within its domain, because almost any structural issue could affect the overall performance of the economy. The IMF remains stalwart in this claim, despite the fact that its role is explicitly limited by the Articles of Agreement to matters of macroeconomics when it deals with a country.

Since the mid-1970s, industrialized countries have ceased to draw any resources from the IMF. Currently, developing countries exclusively form the IMF’s clientele, despite the fact that since its inception, the IMF has never been viewed as having a specific role in developing countries. The Bretton Woods system was designed by Western, and, for the most part, developed countries that were (and continue to be) committed to the principles of free-market economics. Although the IMF conditionality remains firmly founded on exchange rate devaluation and domestic demand restraint under the Articles of Agreement, in practice,

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19 Although the purposes of the two institutions remained distinct, their activities became increasingly intertwined:

[The World Bank went beyond just lending for projects... to providing broad-based support, in the form of structural adjustment loans; but it did this only when the IMF gave its approval. The IMF was supposed to focus on crises; but developing countries were always in need of help, so the IMF became a permanent part of life in most of the developing world.]

STIGLITZ, supra note 10, at 14.

20 See Articles of Agreement, supra note 16, art. I; see also Graham Bird, The International Monetary Fund and Developing Countries: A Review of the Evidence and Policy Options, in THE POLITICS OF GLOBAL GOVERNANCE: INTERNATIONAL ORGANIZATION IN AN INTERDEPENDENT WORLD [hereinafter GLOBAL GOVERNANCE] 277, 307-08 (Paul F. Diehl ed., 2d ed. 2001) (explaining that the G-7 countries, which include the United States, Japan, Germany, Canada, Italy, France, and the United Kingdom, have encouraged the IMF to return to its core concern of macroeconomics).

21 To most developing countries, the IMF is a lender of last resort. See Bird, supra note 20, at 286 (explaining that most developing countries turn to the IMF when all other financing options have been exhausted).

22 Id. at 277.

23 See Paul F. Diehl, Introduction to Part Four, in GLOBAL GOVERNANCE, supra note 20, at 259 (“[The Bretton Woods] institutions... are still largely controlled by the Western economic powers, either through formal voting procedures or by virtue of their collective power in international economic relations.”).

24 Bird, supra note 20, at 302.

25 See Articles of Agreement, supra note 16, art. V, sec. 3 (stating that the IMF
Conditionality has been used to promote the Washington Consensus\textsuperscript{26} reflecting market fundamentalist ideology.\textsuperscript{27} In response, some developing countries have argued that the Bretton Woods system was, at best, not designed to meet the needs of less developed states, and at worst, designed to perpetuate the dominance of Western countries.\textsuperscript{28}

It is important to remember that the concept of conditionality under the Articles of Agreement maintains the implied can place conditions on request for drawings); see also Guidelines on Conditionality, Ex. Bd. Decision No. 6056-(79/38) (Mar. 2, 1979), in SELECTED DECISIONS OF THE INTERNATIONAL MONETARY FUND 94 (1995) (stating that “[p]erformance criteria will normally be confined to (i) macroeconomic variables, and (ii) those necessary to implement specific provisions of the [Articles of Agreement] or policies adopted under them.”).

\textsuperscript{26} The term “Washington Consensus” was invented by economist John Williamson to describe the lowest common denominator of policy advice being addressed by the Washington-based institutions to be given to Latin American countries as of 1989.

Williamson’s ten policy prescriptions were:

1. Fiscal discipline;
2. Redirection of public expenditure;
3. Tax reform;
4. Financial liberalization;
5. Adoption of a single, competitive exchange rate;
6. Trade liberalization;
7. Elimination of barriers to foreign direct investment;
8. Privatization of state owned enterprises;
9. Deregulation of market entry and competition; and
10. Ensurance of secure property rights.


\textsuperscript{27} See STIGLITZ, supra note 10, at 220-21 (arguing that “market fundamentalism,” which is adopted and strongly promoted by the IMF, is not an established doctrine, even among economists, but that it is a widespread view in developed countries, especially in the United States).

\textsuperscript{28} Diehl, supra note 23, at 259. Contra Milena Makich-Macias, The Effect of The International Monetary Fund Bailout on Growth Countries, 26 BROOK. J. INT’L L. 1755, 1757 (2001) (arguing that the IMF strengthens the international community by its succinct understanding of the different perceptual, social, and cultural norms unique to each economy).
jurisdictional barrier between the IMF and its sovereign states. \(^{29}\)

Under Article V(3), the jurisdictional barrier between the IMF and sovereign states cannot be breached even in the context of extending financial assistance. \(^{30}\) Matters that are "essentially within the domestic jurisdiction of the member state" \(^{31}\) should not be appropriate for inquiry, advice, or command by the IMF. \(^{32}\)

However, in reality, the intrusiveness of the IMF's conditionality can be illustrated by its structural conditionality covering pricing policy, trade liberalization, privatization, the structure of taxes and government expenditure, \(^{33}\) and the reform of the financial sector. \(^{34}\)

The problem is that a state's domestic economic policies cannot be separated from its international economic policies, including the BOPs and the value of the state's currency. \(^{35}\)

3. ASIAN MIRACLE OR MIRAGE?: THE ASIAN FINANCIAL CRISIS

3.1. The Crash

3.1.1. Asian Economies before the Crisis

In the past three decades, the rapid growth of Asian economies has led many Western and Asian pundits to claim that the "Asian

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\(^{29}\) See Lowenfeld, supra note 5, at 262 ("Even as the conditions for drawings or stand-by arrangements became more refined, with phased drawings and performance criteria, the implied jurisdictional barrier was maintained."). For a discussion of the implied jurisdictional barrier, see supra Section 1.2.

\(^{30}\) See Articles of Agreement, supra note 16, art. IV, sec. 3 ("These principles shall respect the domestic social and political policies of members, and in applying these principles the Fund shall pay due regard to the circumstances of members.").

[F]or instance, the Fund might say to a government, you must keep your budgetary deficit to within five percent of your Gross National Product (GNP); but the Fund could not decide or even advise on whether this prescription would be carried out through a reduction in veterans' benefits, farm subsidies, or road building.

Lowenfeld, supra note 5, at 260.

\(^{31}\) See U.N. CHARTER, supra note 15, art 2, para. 7.

\(^{32}\) See Lowenfeld, supra note 5, at 260-61 ("The Fund could not prescribe, much less condition aid upon, say, privatizing electric power production or opening telecommunications up to foreign investment.").

\(^{33}\) These policies are consistent with the Washington Consensus. See supra note 26 for a description of the Washington Consensus.

\(^{34}\) See Bird, supra note 20, at 283.

\(^{35}\) See Lowenfeld, supra note 5, at 261.
miracle” was based on a superior “Asian system” and was underpinned by uniquely superior “Asian values.” Indeed, the World Bank published a book entitled “The East Asian Miracle” in 1993. The extraordinarily high savings rate and government-initiated economic development policies were characterized as the common features of Asian economies that had shown impressive economic growth records in a relatively short period of time. However, only four years after the World Bank’s publication of the book, the economies of most Asian countries collapsed dramatically.

Collectively, Asian economies have put an emphasis on macrostability. As in the Washington Consensus, trade was

36 Long before the crisis, at least one economist had argued that economic growth in Asian countries was not a miracle and that there was no such thing as a truly unique Asian system. See Krugman, supra note 8, at 22 (arguing that there was nothing miraculous about Asian economies, if one means by “miracle” something incomprehensible). But see Stiglitz, supra note 10, at 91 (arguing that high savings rate and well-organized government policies were unique in Asia); see also C.P. Chandrasekhar & Jayati Ghosh, Hubris, Hysteria, Hope: The Political Economy of Crisis and Response in Southeast Asia, in TIGERS IN TROUBLE: FINANCIAL GOVERNANCE, LIBERALISATION, AND CRISIS IN EAST ASIA [hereinafter TIGERS IN TROUBLE] 63, 63 (K.S. Jomo ed., 1998) (arguing that it is important to remember that the development trajectories and levels of performance have differed greatly throughout the region).


39 See Stiglitz, supra note 10, at 90-92 (arguing that the combination of high savings rates, government investment in education, and state-directed industry policy was the key element to the Asian economies’ success and that the IMF did not give credit to this strategy devised by the Asian governments because it was fundamentally inconsistent with the Washington Consensus).

40 Cf. Chandrasekhar & Ghosh, supra note 36, at 63 (“The Philippines was never really much of a ‘tiger’ except in the matter of export growth, and that has not translated yet into any major transformation of domestic productive structures.”).

41 Macrostability refers to stability on the macroeconomic level, but is almost never defined. Roughly speaking, it refers to anything that goes well from a macroeconomic point of view and is strongly related to inflation, its effect, and
important, but the emphasis was on promoting exports, not removing impediments to imports. Trade liberalization was only gradually completed, as new jobs were created in the export industries. As for financial and capital market liberalization, the East Asian countries were not anxious to open such markets. Rather than promoting privatization, some Asian governments, at the national and local levels, helped create efficient enterprises that played a key role in successful economic growth. The critical point to note is that Asian governments took responsibilities in shaping and directing markets, while the Washington Consensus emphasized decentralization and a minimalist role for government.

3.1.2. July 2, 1997

On July 1, 1997, control of Hong Kong reverted to China. Some were worried that the reversion would lead to loss of some civil

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42 See J.A. Kregel, East Asia Is Not Mexico: The Difference Between Balance of Payments Crises and Debt Deflation, in TIGERS IN TROUBLE, supra note 36, at 44, 49 (explaining that multilateral agencies such as the Organization for Economic Cooperation and Development and the IMF were actively encouraging broad liberalization, but given the high savings rates in most Asian economies and the preponderance of foreign direct investment flows in others, and the relative absence of demands for consumption finance, bank lending was directed in the two areas).

43 China is a good example of limited and gradual financial and capital market liberalization. See STIGLITZ, supra note 10, at 92 (commenting that China "still ha[s] a long way to go" for financial and capital market liberalization).

44 Notably, South Korean, Indonesian, and Chinese governments were engaged in market interventions during and after the Asian financial crisis.

45 See STIGLITZ, supra note 10, at 92 (explaining that the East Asian governments set industrial policies to shape the future direction of the economy, education, and investment policies to close the knowledge and technology gap, to reduce poverty, and to promote social equality and social cohesion).

46 For a discussion of decentralization and its impact on macrostability, see The World Bank Group, Decentralization NET: Macrostability (noting that "[a]t the macro level, an important concern has been that decentralization may make stabilization policies more difficult to implement, and indeed, may itself lead to destabilizing levels and composition of overall public expenditures and public debt."), at http://www1.worldbank.org/publicsector/decentralization/macro stability.htm (last visited Oct. 20, 2003).

47 On July 2, 1997, the Thai baht collapsed, which started the "greatest" economic crisis since the Great Depression. See STIGLITZ, supra note 10, at 89 (explaining that the crisis spread from Asia to Russia and Latin America and threatened the entire world).
liberties in the city, but few were concerned about the slight chance that the reversion would change the status of the city as one of the financial centers in the world.\textsuperscript{48} In fact, many believed that Asia had great growth potential. Indeed, no one knew that Thailand would have to devalue the baht the next day,\textsuperscript{49} and that the devaluation would trigger the Asian financial crisis, which in turn would create crisis in Russia and Latin America over the next few years. Although the currency crisis hit Thailand in early March of 1997\textsuperscript{50} and the trade deficit increased, no one imagined that this classic currency crisis\textsuperscript{51} would spread to the Philippines, South Korea, Indonesia, and Malaysia. The contagion from the Asian crisis had a significant impact in the world economy; Russia defaulted on its debt in 1998,\textsuperscript{52} which skyrocketed Brazilian interest rates and terrified the U.S. bond market right before the turn of the millennium.

3.2. Origin of the Crisis

3.2.1. Fundamental Economic Problems in Asia?

Although there is no consensus about what caused the Asian financial crisis, fundamentals in Asia were not generally problematic. Most crisis economies in Asia had been near surplus on their trade balances, if not on their current account balances, and had long-term records of fiscal rectitude. Moreover, their

\textsuperscript{48} See Krugman, supra note 8, at 2 ("[T]he transfer of power that day seemed to proclaim the triumph . . . of capitalism—a system so successful, so dominant, that even the People's Army posed no threat to business as usual.").

\textsuperscript{49} See id. at 93 (stating that when the Thai government dissolved the baht on July 2, 1997, the baht price of a dollar soared fifty percent over the next few months, even though typical calculations suggested that the baht would have to fall about fifteen percent to make Thai industry cost-competitive). Faced with a series of speculative attacks, the Thai government had two choices: (1) raising interest rates, which would discourage foreign investment greatly; or (2) dissolving the baht. On July 2, 1997, the Thai government had to dissolve its currency because it ran out of its foreign exchange reserve. See id. at 90-91.

\textsuperscript{50} See Laurids S. Lauridsen, Thailand: Causes, Conduct, Consequences, in TIGERS IN TROUBLE, supra note 36, at 137, 145 ("The currency crisis hit Thailand in early march 1997 after a speculative attack on the baht in February . . . ").

\textsuperscript{51} See Krugman, supra note 8, at 91-92 (stating that the baht devaluation was a textbook-type currency crisis).

\textsuperscript{52} See Stiglitz, supra note 10, at 199-200 ("The East Asian crisis spread from there to Russia through the collapse of oil prices . . . ").
trade deficits were not great. Given that the fundamental indicators looked healthy, the IMF and the U.S. Treasury held the view that the cause of the crisis lay in the problem of internal management. However, if corruption and nepotism were the true cause of the Asian financial crisis, the subsequent economic recovery would not have been possible without fundamental changes. The fact that recovery from the crisis came without fundamental changes demonstrates that the crisis was closer to a simple “panic.”

3.2.2. Possible Causes

If cronyism and corruption in Asia were not the causes of the crisis, what caused the sudden capital flight, sharp fall in currency values, bankruptcy, and massive layoffs in Asia? A more widely-supported view among economists is that the vulnerability of the financial sector due to the under-regulated expansion of capital and financial markets caused the crisis, at least in part. Several

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53 See Kregel, supra note 42, at 46 (arguing that it could not have been excessive private consumption that led to the crisis because imports were not dominated by luxury consumption goods, the savings ratio was extremely high, and banks were not financing unsustainable consumption booms).

54 See Lowenfeld, supra note 5, at 267 (stating that Asian countries had experienced low budget deficits, relatively low public debt, inflation in single digits, rapid economic growth, and high savings and investment rates).

55 See STIGLITZ, supra note 10, at 211 (“In the East Asia crisis, the IMF and the U.S. Treasury quickly sought to blame the problems on the borrowing countries, and in particular on their lack of transparency.”); Walden Bello, Back to the Third World The Asian Financial Crisis Enters Its Second Year, 27 FOCUS ON TRADE (July 1998) (“Washington and the IMF insisted that ‘crony capitalism’ or corrupt relations between the private and public sectors was the main issue and that the solution lay principally in eliminating corruption and achieving greater ‘transparency.’”), available at http://www.asienhaus.org/asiancrisis/third_world.htm (last visited Oct. 20, 2003).

56 KRUGMAN, Introduction, supra note 10, at x.

57 See, e.g., STIGLITZ, supra note 10, at 99 (“I believe that capital account liberalization was the single most important factor leading to the crisis.”); G.K. Helleiner, Afterword: The East Asian and Other Financial Crises: Causes, Responses, and Prevention, in TIGERS IN TROUBLE, supra note 36, at 232, 235 (“[M]ost [economists] now assign some responsibility for the crisis to premature financial liberalisation [sic] and, in particular, liberalisation [sic] of the external capital account . . . .”); Bello, supra note 55 (stating that the IMF continues to push radical financial liberalization, ignoring the mounting evidence that it was uncontrolled capital movements that triggered the crisis).

58 See K.S. Jomo, Introduction, in TIGERS IN TROUBLE, supra note 36, at 1, 23 (stating that market liberalization in Asia not only reduced monitoring and supervision of banking operations and transactions in capital and financial
years before the crisis, many Asian countries opened up their financial markets, which led to the undermining of monetary and financial governance. There was no development of adequate regulation as demonstrated by massive short-term borrowing abroad by the private sector.

Some commentators have suggested that a moral hazard involving over-guaranteed but under-regulated financial intermediaries was the cause of the crisis. Most notably, Professor Paul Krugman at Princeton University has argued that the moral hazard problem not only distorted investments, but also led to over-investment at the aggregate level and overpricing of assets.

Many economists now agree that a loss of confidence in the market started a vicious circle of financial and economic collapse:

markets, but also increased the scope for and activity in currency speculation).

59 See id. at 7 ("[The] Asian currency and financial crises . . . have been partly due to financial liberalisation . . .").

60 International financial instability is more likely in a world of increased economic interdependence and free global capital flows because of the reduction of financial controls. For a general discussion of financial markets and financial liberalization, see id. at 9-13.

61 See id. at 7; Chandrasekhar & Ghosh, supra note 36, at 70 (explaining the policies in Indonesia and Malaysia).

62 See Yilmaz Akyüz, The East Asian Financial Crisis: Back to the Future, in TIGERS IN TROUBLE, supra note 36, at 33, 35 (arguing that domestic banking regulations cannot not prevent the excessive non-bank private sector borrowing made possible by financial market liberalization and noting that a significant percentage of East Asian private borrowing from international banks was made by non-bank firms). But see Jomo, supra note 58, at 23 ("Financial liberalisation has also reduced monitoring and supervision of financial [sic], including banking operations and transactions, including those of a prudential nature.").


64 Id. (arguing that access to global capital markets allowed moral hazard in the financial sector to translate into excessive real capital accumulation). Thus, Krugman's point regarding the cause of the Asian financial crisis also relates to financial and capital market liberalization.

65 See KRUGMAN, supra note 8, at 97-98 ("[I]nvestors . . . regarded the troubles of one Asian economy as bad news about the others; when an economy is vulnerable to self-validating panic, believing makes it so."); STIGLITZ, supra note 10, at 94-95 (explaining the effect of self-fulfilling prophecies in Asian economies during the crisis); Jomo, supra note 58, at 5 ("Perceiving the Southeast Asian region as much more integrated than it actually is . . . the panicky investment decisions of fund managers based outside the region . . . have often been 'herd-like,' causing a 'contagion' or 'domino' effect throughout the region."); see also Chart P2: IMF Prescription/East Asian Dilemma in TIGERS IN TROUBLE, supra note 36, at xiv.
a feedback loop from confidence, to financial markets, to the real economy, and back again to confidence. Even the IMF has stated that its priority in response to the Asian Economic Crisis ("Crisis") was to help restore confidence. Significantly, Michel Camdessus, then Managing Director of the IMF, openly stated that the IMF sought to restore market confidence in response to the Crisis.

4. SAVING ASIA?: THE IMF POLICIES IN SOUTH KOREA AND OTHER ASIAN COUNTRIES

4.1. Who Failed and Who Rescued South Korea?

On September 30, 1996, approximately thirty-four years after the South Korean government first instituted economic reforms, South Korea joined the Organization for Economic Co-operation and Development ("OECD"). Unlike other crisis economies in

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66 The IMF agrees on this point. See The International Monetary Fund, Recovery from the Asian Crisis and the Role of the IMF, June 2000 [hereinafter The Role of the IMF] ("[A] change in market sentiment could and did lead into a vicious circle of currency depreciation, insolvency, and capital outflows, which was difficult to stop. Contagion spread rapidly in the region after the devaluation of the baht, as other countries were perceived by investors as facing similar weaknesses that cast doubt on their credit-worthiness."), at http://www.imf.org/external/np/exr/ib/2000/062300.htm#box2 (last visited Oct. 20, 2003).


69 See KRUIGMAN, supra note 8, at 24 (stating that per capita income in South Korea rose almost seven percent per year over the period of South Korea's economic transformation).

70 The Organization for Economic Co-operation and Development ("OECD") represents thirty member states who share a commitment to democratic government and the market economy. The OECD states that it plays a prominent role in fostering good governance in public service and in corporate activity. The OECD has been called a think tank, a monitoring agency, a rich man's club, and
Asia, the South Korean economy was large\textsuperscript{71} and relatively sound.\textsuperscript{72} Nevertheless, it was forced to join the unfortunate club\textsuperscript{73} of countries receiving IMF rescue funds\textsuperscript{74} at the end of 1997.

\textbf{4.1.1. High-speed Industrialization}

South Korea’s impressive and robust period of economic growth\textsuperscript{75} was based on an institutional framework in which the government played a central role in setting economic and industrial policies and had a close working relationship with the private sector.\textsuperscript{76} The government not only favored strategic sectors and industries\textsuperscript{77} by providing them with subsidized credit through an unacademic university. See generally The Organization for Economic Cooperation and Development, The Overview of the OECD, at http://www.oecd.org/document/18/0,2340,en_2649_201185_2068050_1_1_1_1,00.html (last visited Oct. 20, 2003).

\textsuperscript{71} See Nicola Bullard et al., Taming the Tigers: The IMF and the Asian Crisis, in TIGERS IN TROUBLE, supra note 36, at 85, 100 (“[Pre-crisis] figures placed South Korea as the eleventh largest economy in the World.”).

\textsuperscript{72} See Ha-Joon Chang, South Korea: The Misunderstood Crisis, in TIGERS IN TROUBLE, supra note 36, at 222, 223 (“[T]he current account deficit [in South Korea on the eve of the crisis] was just over 3 per cent of GNP . . . . The Korean annual budget has been largely in balance and gross public debt amounts to only 3 per cent of GDP . . . .”).


\textsuperscript{74} South Korea received a $57 billion rescue package from the IMF. For details of the IMF rescue package, see discussion infra Section 4.1.3.

\textsuperscript{75} In thirty-four years starting in 1963, South Korea recorded a nine-fold increase in per capita income. KRUGMAN, supra note 8, at 24; see also Bullard, supra note 71, at 100 (“Annual economic growth over the same period averaged slightly over 7 per cent . . . .”).

\textsuperscript{76} See Bullard, supra note 70, at 100 (explaining that the South Korean government had a commanding role in its relationship with the private sector).

\textsuperscript{77} For example, the South Korean government promoted the steel industry, helping to create Pohang Iron and Steel Company, Ltd. in the 1960s. Generally, the South Korean government promoted the development of heavy and chemical industries. See Tain-Jy Chen & Ying-Hua Ku, Differing Approaches, Differing Outcomes: Industrial Priorities, Financial Markets, and the Crisis in Korea and Taiwan, in WEATHERING THE STORM: TAIWAN, ITS NEIGHBORS, AND THE ASIAN FINANCIAL CRISIS [hereinafter WEATHERING THE STORM] 111, 113-18 (Peter C. Y. Chow & Bates Gill eds., 2000).
state banks, but also protected them from foreign corporations' competition in the domestic market. These incubated industrial conglomerates, known as chaebol, were later pushed to compete with foreign companies in the international market. The state-bank-chaebol nexus played a key role in economic growth in South Korea until the early 1990s.

4.1.2. Origins of the Crisis

The most important change in the South Korean economy in the early 1990s was that the new government "abandoned its traditional role of coordinating [and regulating private] investments in large scale industries," which allowed excess capacity to build up in important industries like steel, shipbuilding, automobiles, and semiconductors. After the formation of the World Trade Organization in January 1995,

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78 Thus, these industries were able to obtain "preferential policy loans at subsidized interest rates." See Peter C. Y. Chow, The Asian Financial Crisis and Its Aftermath, in WEATHERING THE STORM, supra note 77, at 3, 4.

79 This is a classic protectionist trade policy, where governments promote their export industries, while protecting their import substitution industries. For a general discussion of trade policies, see STRATEGIC TRADE POLICIES AND THE NEW INTERNATIONAL ECONOMICS (Paul Krugman ed., 1986).

80 See Chen & Ku, supra note 6, at 113 ("Korean policymakers made it clear from the beginning that the eventual goal of the [heavy and chemical industries development] drive was to make these industries the mainstay of Korean exports.").

81 See Bullard, supra note 71, at 101 (explaining that the South Korea's state-led strategy was extremely successful). But see KRUGMAN, supra note 8, at 37 (arguing that "the cozy collaborative relationship" between business and government fostered private gain at the economy's expense).

82 Compare Tatsuo Yanagita, International Monetary Fund Conditionality and the Korean Economy in the Late 1990s, in WEATHERING THE STORM, supra note 77, at 19, 36-37 (arguing that the seeds of the crisis were planted by the close tripartite relationship among the government, state banks, and Korean industrial conglomerates), with KRUGMAN, supra note 8, at 22, 37 (arguing that theories identifying the relationship as the root of the crisis are not very convincing).

83 In 1992, Young-sam Kim was elected the new President in South Korea after over three decades of military regime.


85 Cf. STIGLITZ, supra note 10, at 118-27 (arguing that the apparent excess capacity of the chip industry in South Korea was not truly excessive).

86 The World Trade Organization ("WTO") was established at the Uruguay Round negotiations. The WTO is the only international organization dealing with the global rules of trade between nations. Its main function is to ensure that trade
South Korea was under heavy pressure to liberalize its trade regulations. Moreover, membership in the OECD forced South Korea to adopt a more liberal stance towards foreign capital and finance.\(^8\) Also, it is important to note that South Korea followed the IMF's strong recommendation with respect to capital market liberalization during the early 1990s.\(^8\)

Although there has been some discussion\(^8\) that the South Korean crisis was caused by an inefficient, over-regulated, and corrupt state-directed economic system, the crisis is largely "financial" in origin, rather than a crisis of the "real economy."\(^9\) By October 1997, it was estimated that non-performing loans by South Korean enterprises had escalated to over $50 billion... [making foreign banks] which already had about $200 billion worth of investment and loans in South Korea... reluctant to release new funds to the country.\(^9\) By late November 1997, South Korea sought an IMF bail-out.\(^9\)

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flows as smoothly, predictably, and freely as possible. See generally THE WORLD TRADE ORGANIZATION, TRADING INTO THE FUTURE: WTO (2d ed. 2001).

\(^8\) See Bullard, supra note 71, at 101; see also Chandrasekhar & Ghosh, supra note 36, at 72 (arguing that the crisis was caused by liberalization and deregulation rather than excessive regulation).

\(^8\) The IMF Economic Counselor (also acting as the Director of the Research Department) admits that South Korea was not warned by the IMF regarding the dangers involved in capital market liberalization. See Kenneth Rogoff, The IMF Strikes Back, FOREIGN POL'Y 134 (2003) ("Of course, in some cases—most famously South Korea and Mexico—the fund didn’t warn countries forcefully enough about the dangers of opening up to international capital markets before domestic financial markets and regulators were prepared to handle the resulting volatility."). available at http://www.imf.org/external/np/vc/2003/ 021003.htm (last visited Oct. 20, 2003).

\(^8\) See Chang, supra note 72, at 222 ("When the South Korean crisis first broke in November 1997, many commentators argued that it was proof that its famous state-led economic system had reached its limits.").

\(^9\) See Chang, supra note 72, at 226  (stating that "South Korea ... appeared economically stronger than many OECD countries" when it joined the OECD); Chang, supra note 72, at 226 (stating that the South Korean crisis was caused by the high ratio of short-term foreign debt and certain high-profile bankruptcies, combined with the fallout from the Southeast Asian crisis); Bello, supra note 55 (arguing that crony capitalism in Asia could not have been the real cause of the crisis because the practices of crony capitalism were very much a part of economic life during the three decades that East Asian countries led the world in GNP growth).

\(^9\) Bullard, supra note 71, at 102.

\(^9\) See Chang, supra note 72, at 224 (stating that in 1997, South Korea’s foreign debt decreased to $116 billion); see also Bullard, supra note 71, at 103 (explaining that South Korea had to pay sixty-six billion dollars within one year when it asked for the IMF loan).
4.1.3. The IMF Comes to the "Rescue"

On December 4, 1997, the executive board of the IMF approved a three-year stand-by arrangement with South Korea amounting to $21 billion. Financing amounting to $14 billion had been committed by the World Bank and the Asian Development Bank, and interested countries pledged to lend $22 billion, for a total package of $58.4 billion. For the first time after the mid-1970s, an advanced, industrialized country was subject to the tough IMF conditionality usually reserved for developing countries. The IMF negotiated the terms of a Mexico-style bail-out "to restore economic health and stability."

In addition to conditionality concerning macroeconomic indicators such as growth in Gross Domestic Product ("GDP") and an increase in usable foreign exchange reserves, the conditionality imposed on South Korea in exchange for the rescue package can be summarized as:

(a) fiscal and monetary tightening, including a tax increase, a budget cut, and an increase of the interest rate;
(b) institutional reforms, including establishing an independent central bank, closing "bad" private financial institutions, and accelerating the approval of foreign entry into the domestic financial sector;
(c) trade and financial liberalization, and imposition of GAPP;
(d) review of corporate governance and structure; and
(e) labor market reform.

93 Yanagita, supra note 82, at 24.
94 A Mexico-style bail-out program was the IMF's prescription for the Mexican peso crisis in 1994-1995 and is characterized by high interest rates and broad structural reforms. See generally Krugman, supra note 8, at 38-45; Kregel, supra note 42, at 44-47.
96 See Lowenfeld, supra note 5, at 268 (explaining conditionality imposed in South Korea by the IMF).
97 IMF conditionalities are generally accepted in a Letter of Intent, which is nominally a letter from the Finance Minister or a comparable official to the Managing Director of the Fund, but is in fact a negotiated document. See id. at 161.
The IMF conditionality thus not only included macroeconomic policy, but also financial sector and corporate restructuring, capital accounts, and trade liberalization. With regard to macroeconomic policy, the IMF did not tailor its conditionality to the South Korean economic situation; rather, it used its traditional Mexican-style bail-out formula. Even though there was no budget deficit problem in South Korea, the IMF imposed fiscal restraints, requiring tax increases and government expenditure cuts. The IMF stated that the structural reforms were necessary to restore both domestic and foreign investors' confidence; however, there has been widespread criticism of the IMF rescue package in South Korea.

For example, closing ailing merchant banks and reducing risky assets made both more attractive targets for foreign takeover, which had already been made easier by the IMF conditionality that required South Korea to allow foreign banks and financial institutions to set up wholly-owned branches ahead of South Korea's financial liberalization agenda. The IMF conditionality also required opening the bond market by the end of 1997 and opening domestic markets to cars and other key Japanese industrial goods by mid-1999. These examples illustrate that the IMF did not merely make sure that South Korea would recover from the crisis in order to repay the IMF loan; rather, the IMF used the traditional IMF formula of fiscal and monetary tightening, combined with nods to the special interests of foreign bankers and business.

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100 See, e.g., KRUGMAN, supra note 8, at 114-17; STIGLITZ, supra note 10, at 113-20; Bello, supra note 55.
101 See Chossudovsky, supra note 95, at 89 (“Western corporations have gone on a shopping spree with a view to buying up industrial assets at rock-bottom prices. The devaluation has already depressed the dollar value of Korean assets, [and] the IMF-sponsored [banking and foreign takeover] reforms should contribute to a further slide.”).
102 However, in January 1998, the IMF had agreed to drop some of its earlier conditionals. The IMF dropped its insistence on a budgetary surplus and adjusted the inflation target and the monetary growth target. See Chang, supra note 72, at 229.
103 See Chossudovsky, supra note 95, at 89 (“The details of the [IMF’s] economic reform program...had already been decided in advance in consultation with the U.S. Treasury, Wall Street’s commercial and merchant banks as well as with major banking interests in Japan and the European Union.”).
4.1.4. Recovery of the South Korean Economy

One of the key IMF terms was a labor market reform that would allow companies to lay off workers, an action which had previously required legislative amendments. Combined with the IMF's contraction policy, the IMF's conditionality on labor market flexibility caused job losses, business closures, and an absolute loss of purchasing power, contrary to the IMF's statement that a social safety net was established. As a result, IMF conditionality evoked widespread public anger in South Korean society.

At the end of 1999, South Korea had "a stunning boom." The IMF states that the success of South Korean economic recovery provides the justification for the IMF's structural reforms.

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104 Specifically, the IMF conditionalities required the South Korean government to: (1) clarify the circumstances and procedures for layoffs; (2) relax restrictive legal provisions relating to private job placement and manpower leasing services; (3) triple budgetary resources for an unemployment insurance fund, including training support and employment stabilization; and (4) expand unemployment benefits to cover firms with more than ten employees and to increase the minimum benefit level to seventy percent of the minimum wage. See Letter of Intent from the Government of the Republic of Korea to Michel Camdessus, Managing Director of IMF (Feb. 7, 1998), available at http://www.imf.org/external/np/loi/020798.htm. Although these changes may have been desirable, their effectiveness was dependent on concomitant changes in South Korean attitudes regarding job security, taxation, the welfare state, corporate recruitment, remuneration structure, and industrial training. Chang, supra note 72, at 230.

105 An estimated two hundred companies per day have shut down during the South Korean crisis, reaching a peak of three-hundred and forty on January 5, 1998. This translated into about four thousand more employees finding themselves on the street every day. Korean Confederation of Trade Unions, Unbridled Freedom to Sack Workers Is No Freedom at All, KCTU NEWS (Jan. 13, 1998), at http://www.kctu.org/arguments/sp009.htm (last visited Oct. 20, 2003).

106 See Bullard, supra note 71, at 118.

107 See Neiss, supra note 99, at 10 ("A social safety net was established, with the main focus on unemployment and health insurance, and retaining retrenched workers, so as to maintain social peace in a difficult period of adjustment when the traditional family support system has been eroding.").

108 KRUGMAN, Introduction, supra note 10, at vii; see also The Role of the IMF, supra note 66 ("[T]he recoveries were unexpectedly robust, especially in Korea, where growth reached 10.75 percent in 1999 as a whole.").

109 See The IMF's Response, supra note 67 ("[T]here have been some signs of bottoming out in Korea . . . ").
4.2. Questioning the IMF Conditionality in Asia

As discussed in Section 3 of this Comment, the crisis that began in Thailand quickly spread to other countries in the same region. The IMF volunteered its "expert" advice not only to countries that ultimately took IMF rescue loans, but also to Malaysia and the Philippines, countries that did not seek IMF loans.

Despite what they were told by the IMF, the governments of South Korea and Malaysia took an active role in the financial restructuring of a large fraction of the firms in distress in their countries and achieved dramatic results within two years. In contrast, restructuring in Thailand languished despite the fact that the country closely followed the IMF strategy.

One of the most controversial aspects of the IMF conditionality in Asia was the fact that a double standard was used in the treatment of domestic and foreign interests. The changes of foreign ownership rules included in the IMF's conditionality gave

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10 Indonesia, Thailand, and South Korea took rescue loans from the IMF.

11 Despite the fact that Malaysia has relatively little foreign debt compared to other Asian crisis economies, Malaysian officials have considered adopting IMF policies without seeking IMF loans. K.S. Jomo, Malaysia: from Miracle to Debacle, in TIGERS IN TROUBLE, supra note 36, at 181, 191.

12 Malaysia imposed capital controls in September 1998, largely aimed at the offshore ringgit (the Malaysian currency) market in Singapore and short-term portfolio flows. Malaysian authorities believed that the offshore market constrained their ability to bring down interest rates rapidly. Controls took the form of requirements to bring the ringgit on-shore by the end of 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. See Paul Krugman, Saving Asia: It's Time to Get Radical, FORTUNE, Sept. 7, 1998 75, 79-80 [hereinafter Krugman, Saving Asia] (suggesting that imposing exchange controls may be one way to get out of the crisis), available at http://www.pkarchive.org/crises/SavingAsia.html (last visited Oct. 20, 2003); An Open Letter from Paul Krugman to Malaysian Prime Minister Mahathir (Sept. 1, 1998) (discussing the currency control strategy that Mahathir adopted at Krugman's suggestion), at http://web.mit.edu/krugman/www/mahathir.html (last visited Oct. 20, 2003).

13 See STIGLITZ, supra note 10, at 118 (noting the IMF view that governments should not take an active role in financial restructuring but should push for real restructuring, selling assets, and bringing in outside management).

14 See id. (discussing that financial restructuring usually takes a long time and is a slow process).

15 See Jomo, supra note 58, at 20 (arguing that the IMF's double standards compromised its ostensible role as an impartial party working in the interest of the borrowing country).
enhanced rights to foreign investors\textsuperscript{116} while domestic firms were left to the mercy of the market. The IMF’s bail-outs of the private sector had the effect of socializing debt,\textsuperscript{117} leaving the nations’ governments and their taxpayers to bear the burden of the private sector’s failures. The IMF promoted the interests of its major shareholders, particularly the United States.\textsuperscript{118}

Moreover, the IMF-prescribed conditionality accelerated economic contraction, did not stabilize currencies, and did not restore market confidence. The Washington Consensus and typical conditionality applied in the Mexican Tequila crisis in 1994-1995 were used without regard\textsuperscript{119} to the specific circumstances\textsuperscript{120} of the Asian economies hit by the financial crisis.\textsuperscript{121} Many economists argue that the Asian economic crisis was not a typical BOPs crisis, such as those that occurred with such frequency under the Bretton Woods system, or the Tequila crisis.\textsuperscript{122}

\begin{itemize}
\item[\textsuperscript{116}] See supra notes 100-03 and accompanying text.
\item[\textsuperscript{117}] See Jomo, supra note 58, at 20 (explaining that the burden of IMF programs fell “on the public at large”).
\item[\textsuperscript{118}] See Chossudovsky, supra note 95 (arguing that IMF conditionalities in South Korea have been abused to resolve outstanding bilateral issues in favor of the American and Japanese interests).
\item[\textsuperscript{119}] See Jomo, supra note 58, at 19 (“Perhaps partly out of force of habit in dealing with situations in Latin America, Africa, Eastern Europe and elsewhere, where fiscal deficits have been part of the problem, the same prescription (‘one size fits all’) seems to underlie the recent IMF interventions in East Asia.”); Krugman, Saving Asia, supra note 112, at 77 (suggesting that the IMF’s choice was “inevitable: Given not just the economic but the political logic of the situation, and given the success of a similar strategy in Mexico just two years before, how could the IMF and the Treasury not try to repeat their earlier triumph?”).
\item[\textsuperscript{120}] Individual developing countries can differ widely. They face different economic problems, different needs for economic adjustment, and difficult domestic political contexts within which adjustment is pursued (or not pursued). Furthermore, they have different degrees of political, military, and strategic importance. However, “[i]t is hard even for a moderate-sized institution like the IMF to know a great deal about every economy in the world.” STIGLITZ, supra note 10, at 34. In order to show that the IMF lacks detailed knowledge on individual economies, Stiglitz explains that the IMF came up with a misguided policy prescription for the U.S. economy during the Clinton Administration. See id.
\item[\textsuperscript{121}] See Paul Krugman, The Confidence Game: How Washington Worsened Asia’s Crash, NEW REPUBLIC, Oct. 5, 1998, at 23 (explaining how smart economists in Washington, particularly at the IMF and the U.S. Treasury, “did not apply orthodox economic analysis” because they were focused on restoring market confidence instead of economic fundamentals, and that the result “was disaster”), available at http://www.pkarchive.org/crises/krugman1.html (last visited Oct. 20, 2003).
\item[\textsuperscript{122}] Kregel, supra note 42, at 45. In discussing the origin of the Asian financial crisis, Paul Krugman stated:
\end{itemize}
The IMF's one-size-fits-all approach in Asia can be illustrated by its conditionality for the foreign exchange. The IMF told the Asian economies that they should defend their currencies, when they should have been told to let their currencies fall freely. A more reasoned response to the crisis would have been to slow the withdrawal of foreign lending and to ease the conditions of payment. The most appropriate advice would have been "rapid policies to reschedule foreign loans to stop the mad rush to sell assets and buy foreign currency." Instead, the IMF mandated increases in interest rates to extremely high levels, and the high interest rates exacerbated the recession. In turn, investors lost more confidence in these economies. At the same time, the IMF failed to meet its stated purpose of promoting high levels of employment and real income in all Asian economies that received its loans.

The Asian countries, not the IMF, should have determined the terms and pace of their economic reforms—especially the structural reforms that required social, cultural, and legislative changes. The IMF does not have the "right to substitute its technical judgments for the outcome of a nation's political process." The IMF's authority in asserting certain conditionalities is questionable in light of issues of jurisdiction, standing, and sovereignty because these conditionalities lie

\[ \text{It is necessary to adopt an approach quite different from that of traditional currency crisis theory... The currency crises were only part of a broader financial crisis, which had very little to do with currencies or even monetary issues per se. Nor did the crisis have much to do with traditional fiscal issues.} \]

Krugman, supra note 63.

123 As a result, billions of dollars from the IMF loan were spent to maintain the exchange rate at an unsustainable level. STIGLITZ, supra note 10, at 209.

124 Kregel, supra note 42, at 60.

125 Martin Feldstein, Refocusing the IMF, FOREIGN AFF., Mar.-Apr. 1998, at 20, 27. It is interesting that a well-known U.S. economist questioned the IMF's "moral right" in arguing that the IMF was overstepping its bounds.

126 For example, in South Korea, the IMF not only reorganized the central bank (The Bank of Korea), but also redefined the powers of the Ministry of Finance. See Chossudovsky, supra note 95 ("A de facto 'parallel government' has been installed.... Under the [IMF's] bailout, fiscal and monetary policy will be dictated by external creditors. Monetary policy under the IMF's stewardship will be tightened. Government spending on social programmes and infrastructure will be curtailed."). Cf. Lowenfeld, supra note 5, at 272 (stating that "the boundaries between states and the international community" are, in some aspects, "obsolete, at least for those countries that need the IMF, the World Bank, and
outside the IMF’s statutory purposes. It should also be noted that the IMF’s First Deputy Director, Stanley Fisher, stated in 2001, long after the Asian financial crisis:

Notwithstanding the importance of structural policies in the countries to which we lend, there is general agreement that our conditionality in this area has sometimes been too extensive and restrictive. This can be a problem both because broader programs are more difficult to monitor by the [IMF] and implement by the member country, and because excessive conditionality may undermine a country’s ownership of the program.\(^{127}\)

The IMF’s conditionality in Asia went far beyond its stated purpose in the Articles of Agreement of the IMF,\(^ {128}\) given that the Articles of Agreement do not mention trade and investment liberalization, privatization, foreign investment, pension reforms, or public sector austerity measures. In short, not only were many of the IMF conditionalities in Asia economically unsound, they are also questionable in light of the IMF’s statutory authority.

5. THE IMF'S CONDITIONALITY AND OTHER POLICY OPTIONS

5.1. The Role of the IMF's Conditionality in Asia: The IMF's Position

The IMF takes the position that its set of conditionality measures imposed\(^ {129}\) on Asian economies—which included related agencies” and that those agencies’ authorities and restraints are, to some extent, inarticulate).


\(^{128}\) See supra notes 16-17 and accompanying text; STIGLITZ, supra note 10, at 42 (“[The IMF] has repeatedly sought to extend what it does, beyond the bounds of the objectives originally assigned to it. [The] IMF's mission creep gradually brought it outside its core area of competency in macroeconomics, into structural issues . . . ”).

\(^{129}\) The IMF claims that it never dictates but always negotiates the terms of any loan agreement with the borrowing country. However, in reality, this is not the case.

[These are one-sided negotiations in which all the power is in the hands of the IMF, largely because many countries seeking IMF help are in
macroeconomic measures as well as structural and corporate reforms—was justified and necessary\textsuperscript{130} even though it has acknowledged that the economic crises were not caused by macroeconomic imbalances.\textsuperscript{131} To the IMF, South Korean success\textsuperscript{132} is a vindication of the IMF’s conditionality. However, it is significant that the director of the IMF’s Asia and Pacific Department admitted that some other policy options would have been better: “[A]n earlier decisive shift to fiscal expansion would have been desirable. It would have been desirable to bring in external commercial creditors earlier, and to start dealing with corporate debt right away.”\textsuperscript{133}

5.2. Policy Options and Recommendations

5.2.1. Policy Options

The IMF can potentially fulfill a useful role in developing countries by offsetting sources of market failure that otherwise would severely limit their access to external finance and by improving flexibility in negotiating the conditionality.\textsuperscript{134} In

\textsuperscript{130} See The Role of the IMF, supra note 66 (“While, with the benefit of hindsight, the IMF’s policy advice to these countries during the emergency was not flawless, corrections and adjustments to circumstances were made promptly, and the strategies adopted proved successful in restoring financial market confidence and stability, and in achieving a resumption of economic growth . . . .”) (emphasis added).

\textsuperscript{131} See The IMF’s Response, supra note 67 (“[T]he difficulties that the East Asian countries face are not primarily the result of macroeconomic imbalances.”).

\textsuperscript{132} See Krugman, Introduction, supra note 10, at xi (stating that the IMF claimed that the economic recovery in Korea is a vindication of the IMF’s policies at the end of 1999).

\textsuperscript{133} Neiss, supra note 99, at 10.

\textsuperscript{134} The IMF programs should serve as a seal of good housekeeping to attract private capital. However, they have had the opposite effect because of the bad track record of the IMF, the long-term involvement, and the bad signal IMF involvement itself sends. See, e.g., Stiglitz, supra note 10, at 206 (explaining how the IMF bailout packages make private sector foreign lenders demand even higher interest rates from borrowing countries than prior to the bailouts). But see id. at 250 (stating that the IMF has recognized the failings of its big-bailout strategy in the aftermath of the Argentina debacle in 2001).
prescribing policies for many crises, the IMF has focused on measures that tighten domestic credit, enhance fiscal revenues, reduce governmental expenditures, and adjust the exchange rate.\textsuperscript{135} For example, by the time the IMF had been convinced to introduce additional flexibility in Asia,\textsuperscript{136} conditions had already deteriorated to the point that it was unlikely that there would have been positive growth in the Asian economies in 1998 and possibly even in 1999.\textsuperscript{137}

As an alternative to the IMF's unilateral imposition of the conditionality,\textsuperscript{138} the borrowing countries could decide their economic reforms in the face of economic crises through fair negotiations with the IMF. Given that one of the main purposes of the IMF conditionality is ensuring that a borrowing country pays back the IMF loan,\textsuperscript{139} allowing negotiated conditionalities could increase the chances that the borrowing country will complete the economic reforms. It is reasonable to assume that providing a borrowing country's government with the opportunity to design the program it will implement would significantly increase its sense of ownership. To the extent that lack of ownership adversely

\textsuperscript{135} These are measures taken by the IMF in response to the Tequila crisis in Mexico, which involved a classic BOPs deficit. However, it should be noted that many countries now question the wisdom of the IMF conditionalities even in cases of crises similar to the Tequila crisis. See Bird, \textit{supra} note 20, at 295 ("[T]hese policies . . . failed to generate sustainable economic growth and BOP performance [in Mexico]."). For a discussion of the IMF's typical policy prescription, see \textit{supra} note 119.

\textsuperscript{136} The initial conditionalities imposed upon Thailand, Indonesia, and South Korea were reviewed and rewritten with more lenient terms on fiscal positions and interest rates in the beginning of 1998.

\textsuperscript{137} For example, in February 1998, a month after the IMF adjusted its initial conditionalities, "more than 100 firms were going bankrupt daily" in South Korea. Chang, \textit{supra} note 72, at 229; \textit{see also} Stiglitz, \textit{supra} note 10, at 84 ("[I]f the IMF underestimated the risks to the poor [in the borrowing country] of its development strategies, it also underestimated the long-term social and political costs of policies that devastated the middle class . . . ."); \textit{id.} at 120 ("[T]he Asian crisis was more severe than it should have been, recovery took longer than it needed to, and prospects for future growth are not what they should be [because of the IMF policies].").

\textsuperscript{138} \textit{See} Stiglitz, \textit{supra} note 10, at 42 (explaining that although the IMF's insists that it never dictates the terms of any loan agreement with a borrowing country, the IMF's negotiations with the borrowing countries are in fact one-sided, because a borrowing country seeking IMF help has no bargaining power).

\textsuperscript{139} \textit{See} IMF \textit{Conditionality}, \textit{supra} note 6 (explaining that the conditionality is necessary to ascertain the borrowing country's compliance with the IMF's program).
affects completion of an economic reform necessary to prevent any further economic recession, a sense of ownership should positively affect a borrowing country's motivation to complete the reform. Also, the degree of the IMF's input into the design of conditionality could be varied in the light of a country's track record. This would provide additional incentive for governments not to abandon their programs in mid-course and would help alleviate the problem that arises where previous failure does not exert any adverse effect on future access to the IMF's resources. Nobel laureate economist Joseph E. Stiglitz argues that, as a public institution, the IMF should improve its own transparency by setting its development models and economic policies through democratic processes and open discourse rather than behind closed doors. This approach is consistent with the concept of "the right to know" of the citizens of a borrowing country, given that the IMF is not a private bank but a public international institution.

Also, conditionality should remain strictly limited to exchange rate devaluation and BOPs problems, as stated in the Articles of Agreement. It would be ironic if the liberalization of capital flows, which the IMF has now declared as its major objective,

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140 This problem is illustrated by Mexico's default on the IMF loan in 1982. However, Mexico was provided with yet another IMF loan during the Tequila crisis in 1994-1995. See Lowenfeld, supra note 5, at 263-67.

141 See STIGLITZ, supra note 10, at 228-29 ("The absence of open discourse means that models and policies are not subjected to timely criticism. . . . Secrecy also undermines democracy."). But see An Open Letter from Kenneth Rogoff, Economic Counsellor and Director of Research at the International Monetary Fund, to Joseph E. Stiglitz (July 2, 2002) (criticizing Stiglitz's prescriptions for the IMF's policies and defending the IMF policies), at http://www.imf.org/external/np/vc/2002/070202.htm (last visited Oct. 20, 2003).

142 The citizens' basic "right to know" is consistent with the management of modern public institutions. See, e.g., Freedom of Information Act, 5 U.S.C. § 552 (2003).

143 See STIGLITZ, supra note 10, at 15 ("Worse, many of the policies that the IMF pushed, in particular, premature capital market liberalization, have contributed to global instability.").

144 Although the IMF has not officially amended its Articles of Agreement, it is important to recognize that the Managing Director of the IMF, Michel Camdessus, discussed capital liberalization as one of the IMF's global responsibilities. See Michel Camdessus, Remarks at the Council of Foreign Relations on An Agenda for the IMF at the Start of the 21st Century (Feb. 1, 2000) (arguing that liberalization of capital movements is consistent with the concept of free trade envisioned by the founders of the IMF, suggesting that an amendment to the Articles of Agreement could enable the IMF to seek capital liberalization, and explaining that the IMF had considered proposals to implement liberalization of capital flows), at http://www.imf.org/external/np/speeches/2000/020100.htm
were shown to defeat the IMF's original objective of promoting the free trade of goods and services.\textsuperscript{145} The Asian financial crisis suggests that the two objectives are interdependent but perhaps cannot be achieved simultaneously.\textsuperscript{146}

As the IMF explicitly acknowledges,\textsuperscript{147} the statutory purposes of the IMF are the same as they were when formulated in 1944, at Bretton Woods. Therefore, trade liberalization and capital and financial market liberalization\textsuperscript{148} should not be promoted in the name of the IMF conditionality.

5.2.2. Reforming the IMF Voting Power

Rather than applying the Washington Consensus, the IMF can develop diverse opinions and well-tailored policy options for different countries by changing its own governance. Governance at the IMF can only be changed through altering voting rights to allow developing countries to have a meaningful voice in the determination of policies.\textsuperscript{149}

Currently, the votes are allocated on the basis of economic power.\textsuperscript{150} There are twenty-four seats at the table,\textsuperscript{151} and each seat

\textsuperscript{145} See Jomo, supra note 58, at 23 ("Flexible exchange rates and other related developments have increased the scope for and activity of currency speculation."); Kregel, supra note 42, at 47 (explaining that the increase in capital flows from the developed economies to the Asian economies was based on a false sense of security regarding the stability of exchange rates and the increased role of financial institutions as intermediaries); cf. Jomo, supra note 58, at 24 (arguing that capital market liberalization could not have been a sufficient cause of the crisis and suggesting that little foreign exchange reserve made the crisis economies more vulnerable).

\textsuperscript{146} See Kregel, supra note 42, at 60.


\textsuperscript{148} See Kregel, supra note 42, at 48 (stating Asian countries were under pressure from both the IMF and the World Trade Organization to modernize, liberalize, and deregulate their banking and financial systems).

\textsuperscript{149} Stiglitz compares the current IMF system to “taxation without representation,” because citizens of the borrowing countries ultimately pay the IMF loans back, but they are never given a democratic process to discuss and choose their economic policy options. STIGLITZ, supra note 10, at 20.

\textsuperscript{150} See Articles of Agreement, supra note 16, art. XII, sec. 5 (providing that a member state’s voting power changes according to the additional quotas that the
speaks for a country or several countries.\textsuperscript{152} The United States is the only country with effective veto power,\textsuperscript{153} although collectively European shareholders control twenty-nine percent of the voting rights.\textsuperscript{154}

If the current voting power is to be reallocated, however, current members with strong voting power would have to agree to give up some of their votes at the IMF. The United States is unlikely to give up its effective veto. Likewise, the advanced industrialized countries are not likely to give up their votes so that the developing countries can have more votes. "China would . . . have been willing to increase its capital contribution [to the IMF] if that was required to give it more voting rights."\textsuperscript{155} Thus, a change of governance is not something that can be easily accomplished. However, the proposed reform would provide a true democratic process for adopting IMF policies through negotiations and consensus among the member countries.

6. CONCLUSION

The Asian financial crisis tested the effectiveness and necessity of the IMF conditionality, showing it wanting on both counts. By prescribing the Washington Consensus without regard to the different economic situations in Asian countries, the IMF hardly fulfilled the tasks assigned to it: promoting global stability and helping developing countries in transition achieve stability and growth.

However, whether the IMF conditionalities were economically sound was not the only question that the conditionality raised. The IMF's role in response to a crisis economy should be limited


\textsuperscript{152} Only representatives of the United States, Japan, Germany, France, the United Kingdom, the Russian Federation, China, and Saudi Arabia speak for their own countries. It is important to know that only the United States, Japan, Germany, and France have voting rights greater than 4.5%. Other countries are represented collectively. \emph{Id.} The voting rights of developing countries are very limited. For example, the voting rights of all African member countries are, collectively, only 1.41%. \emph{Id.}

\textsuperscript{153} The United States has 17.1% of the total voting power at the IMF. \emph{Id.}

\textsuperscript{154} \emph{Id.}

\textsuperscript{155} \textsc{Stiglitz}, supra note 10, at 226.
strictly to the purposes stated in the Articles of Agreement.\textsuperscript{156} To do otherwise will only result in erosion of the borrowing countries' economic and political sovereignty. To limit the possibility of erosion of sovereignty, the international community should make a reasonable effort to create a more democratic decision-making process within the IMF.

\textsuperscript{156} In July, 2003, the Independent Evaluation Office of the IMF published a report, extensively evaluating the impact of the IMF conditionality in Indonesia, Korea, and Brazil during recent financial crises and suggesting several recommendations. Though the report did not mention the sovereignty issue directly, the report made a recommendation related to that matter. See \textit{Capital Account Crises}, supra note 9, at 53 ("A crisis should not be used as an opportunity to force long-standing reforms, however desirable they may be, in areas that are not critical to the resolution of the crisis.").